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FARM BANKRUPTCY

HEARINGS

BEFORE THE

SUBCOMMITTEES ON ADMINISTRATIVE PRACTICE AND PROCEDURE, AND COURTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE QUESTION OF THE REMEDIES AVAILABLE TO DEBTORS AND CREDITORS UNDER BANKRUPTCY, HOW THEY RELATE TO THE GREAT PLIGHT OF THE AMERICAN FARM AND THE FARM FAMILY

NOVEMBER 6 AND 12, 1985

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FARM BANKRUPTCY

WEDNESDAY, NOVEMBER 6, 1985

U.S. SENATE, SUBCOMMITTEE ON COURTS,
AND SUBCOMMITTEE ON ADMINISTRATIVE
PRACTICE AND PROCEDURE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittees met, pursuant to notice, at 11:07 a.m., in room 628, Dirksen Senate Office Building, Hon. John P. East, chairman of the Subcommittee on Courts, and Hon. Charles E. Grassley, chairman of the Subcommittee on Administrative Practice and Procedure, presiding.

Also present: Senator Heflin.

Staff present: Samuel Gerdano, counsel to Subcommittee on Administrative Practice and Procedure; and David Anderson, chief counsel and staff director of Subcommittee on Courts.

OPENING STATEMENT OF HON. JOHN P. EAST, A U.S. SENATOR FROM THE STATE OF NORTH CAROLINA

Senator EAST. I would like to call to order this joint hearing of the Judiciary Subcommittees on Courts and also on Administrative Practice and Procedure.

Our purpose here this morning is to consider the question of the remedies available to debtors and creditors under bankruptcy and how they relate to the great plight of the American farm, and the American family farm in particular.

I am honored to be here with my distinguished colleague, Senator Grassley from Iowa, who is chairman of the Subcommittee on Administrative Practice and Procedure. I am chairman of the Subcommittee on Courts. Senator Grassley will be the primary conductor of the joint hearing this morning.

I would like to make a brief comment or two in opening these hearings, turn then to Senator Grassley, and then to the testimony from our distinguished colleagues here this morning. Before proceeding further, I would like to recognize their presence at this time.

We are honored to have our very distinguished colleague, Senator Quentin Burdick of North Dakota. We appreciate your coming this morning. Representative Tauke, who is also from the great State of Iowa, is with us this morning so we are doubly blessed. Thank you for coming, Congressman. Congressman Synar of Oklahoma will be with us in due course. They all share a vital interest in family farm bankruptcy.

We are all aware, and particularly those of us from farm States, of the great financial plight of the American farmer today. The farm economy is an indispensable component of our national economy. Moreover, we would all, I think, agree that it has become an American way of life which contributes greatly to the life of our Nation as a whole.

The problem we are confronted with today is a depression on the American farm. I do not think it is an exaggeration to say a depression. We are trying to be responsive to that compelling need.

I would note, for example, that between 1981 and 1984 real net farm income has declined by 27 percent. During that same period, farmland values have dropped precipitously, as much as a 28-percent decline depending upon the particular area of farming that you are discussing. The end result is that about 30 percent of American farmers today are considered to be in very real financial distress. With a figure of 30 percent you are approaching, if not already into, the category of a depression in the American farm economy.

What we hope to do here this morning is to begin a modest venture of seeking possible avenues to relieve this financial burden on the family farm. Specifically, we will examine the possibility of making financial reorganization more easily accomplished under either, chapter 11 or chapter 13 of the Bankruptcy Code. We are not suggesting that this will solve the underlying economic problems facing American agriculture. However, we do hope that in a modest way it might contribute to allowing the current family farmer to outlast the depression or slump in the farm economy.

We must at the same time, I think, keep in mind not only the plight of the family farmer but also that of the farm creditor, whether he be an agricultural bank, or one of the many other agricultural lenders. They are all a part of an intricate economic pattern and all are suffering some degree of distress. For example, according to the General Accounting Office, the Farm Credit System is projected to sustain a net loss of $2.6 billion for the 12-month period ending June 30, 1986.

My point is that we need to achieve an equitable balance in finding relief for the farmer while not unduly burdening the farm lender. Indeed, to the extent that we further jeopardize the lenders' precarious position, we shall simply compound and exacerbate the problem for all participants in the farm economy.

I look forward to studying the testimony which we will receive today with great care and deliberation to see if we might develop a responsible, equitable, balanced approach to assist the family farmer—indeed, an approach that, ultimately, will benefit the agricultural community as a whole.

I shall end on that note. I would like to turn then to my distinguished colleague, Senator Grassley, for any comments he would like to make, and then we will turn to our distinguished colleagues here this morning and ultimately to the witnesses.

Senator Grassley.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. First of all, Senator East, let me thank you for allowing my subcommittee to join your subcommittee because it is obvious that the Subcommittee on Courts has jurisdiction over this legislation. And I appreciate your moving forward with these hearings.

This is the first of 2 days of hearings. Our purpose is to assess whether the existing bankruptcy laws adequately allow family farms to successfully reorganize. To the extent that these laws impede the ability of farmers to restructure their debt, we will explore the feasibility of changes in the law.

The number of farmers who have been forced to seek protection under the bankruptcy laws has greatly increased. The increase in the number of filings is a natural outgrowth of the problems of insufficient prices, lowered land value, and inadequate access to credit that we face throughout the entire Farm Belt. A bankruptcy proceeding is, in a sense, the last step along the rutted road that is our farm economy.

The numbers are very startling. In the southern district of Iowa alone this year, there have been 387 farm bankruptcy filings. Farm cases now make up more than 16 percent of the cases heard. Last year, there were 258 farm cases filed, and that was better than 12 percent of the docket. As recently as 1980, just so you can get a picture of the rapid increase in the number of farm bankruptcies, just 5 years ago there were only seven farm bankruptcies for the entire year in the southern district of Iowa.

Farm reorganization filings under chapter 11 in the northern district of Iowa more than doubled to a total of 198 in 1984. In the first 6 months of 1985, there were 147 new farm chapter 11 cases filed, a figure that would project to nearly 300 over an entire year. As recently as 1980, there were only two farm chapter 11's for the entire year in the northern district of Iowa.

The situation in the northern district took on tragic proportion this summer with the illness and the death of Bankruptcy Judge William Thinnes. The sole bankruptcy judge for the northern district, Judge Thinnes collapsed at his desk one Saturday in June, before he was to hold hearings on 103 chapter 11 cases. The judge had been working 15 hours per day, 7 days a week, while valiantly attempting to clear the Nation's largest backlog of farm bankruptcies. So the increase in farm bankruptcies has implications not only for farmers and their creditors but also for the courts as well.

The typical debt-burdened farmer has four alternatives. The first is to work out a debt restructuring arrangements with his major creditors. If these negotiations do not produce an agreement that both the farmer and creditor can live with, the bankruptcy law provides three more choices: A chapter 7 or "straight bankruptcy" provides for the orderly liquidation of the debtor's assets; chapter 11 restructures the debt obligations of a farmer pursuant to a plan approved by creditors; and last, chapter 13 enables some creditors to develop and implement a plan for the payment of debts over an extended period of time from the debtor's regular income.

Access to chapter 13 is restricted to debtors with less than $100,000 in unsecured debts and $350,000 in secured debts. Today, only a few farmers file for protection under chapter 13 because those ceilings are too low to cover most farm debt. The generally perceived advantages of chapter 13 proceedings are that they are less complex, burdensome and expensive, which increases their likelihood of success. A debtor also has greater control over the course of chapter 13 cases than in chapter 11, since creditor approval of a debtor's reorganization plan is a requirement only in chapter 11.

The House has passed a bill that would open up the chapter 13 "wage earner" provisions to more family farmers. Companion legislation has been introduced in the Senate. Other pending legislation would, if passed, amend chapter 11 in an effort to streamline the bankruptcy law.

At this point, I should say that I have no predisposition about what is the best solution to the perceived problem. But that is what these hearings are about. And we have assembled 2 days worth of expert witness panels to help us reach the correct policy choice.

Mr. Chairman, that concludes my opening statement. As far as a procedural matter, I would hope that we could have witnesses summarize in 5 to 7 minutes.

Senator **East**. Very well taken and since time is of the essence, I would agree, Senator.

Senator Burdick, we certainly welcome you here this morning, sir, and will be delighted to hear what you have to say on this matter.

STATEMENT OF HON. QUENTIN BURDICK, A U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Senator **Burdick**. Mr. Chairman and members of the committee, good morning, and thank you for giving me the opportunity to testify before you on the timely topic of farm bankruptcy.

Farmers' debt expansion during the boom years has taken its toll on the farm sector in the face of reduced exports and declining asset values. The total farm debt increased from $53 billion in 1970 to well over $200 billion today. The Department of Agriculture has estimated that of the 636,000 commercial-size farms, 31,000 are insolvent. A total of 197,000 farms are financially stressed, which means that their debt/asset ratio exceed the 40 percent level where most farms can be profitable.

Last week, the Senate Agriculture Committee held hearings on the farm credit situation. The hearings focused substantially on a proposal to provide Federal financial assistance to the Farm Credit System. But the farm credit crisis affects more than the Farm Credit System. It affects private banks, individual lenders, and the Federal Government itself which makes substantial credit available through the Farmers Home Administration.

But my concern today, Mr. Chairman, is not for the agriculture lenders. They do not have the same problem in size. Rather, Mr. Chairman, I submit that it is the farmers of this country who have the problem. Our focus should be on their concerns. It is my hope that the committee will keep the farmers uppermost in mind when looking at farm bankruptcy legislative proposals.

Credit availability is our most immediate problem in the farm economy, and boosting income should be our No. 1 priority. However, we also need to provide our farmers with a better opportunity to reschedule some of their debt to permit them to pay it off over the longer course rather than shed it through bankruptcy liquidation, thus leaving us with unemployed farmers, untended land, and additional economic problems.

Because the farmer's income is seasonal in nature, and given the fact that the family farmer may have only one major secured creditor, he is often unable to file a reorganization plan in chapter 11—the creditors vote on acceptance of the plan—that can be confirmed by the Bankruptcy Court. The result is that in some jurisdictions the major creditor files its own plan of reorganization for the chapter 11 farm debtor, and proposes the liquidation of the farmer and the sale of his farm land.

Mr. Chairman, rather than change chapter 13 to deal with this problem, as some have proposed, I propose to add a new subchapter V to chapter 11. Such an addition is clean and simple and will do justice to the family farmer who faces bankruptcy. My proposal is contained in the current Senate bill S. 705. My bill simplifies the procedures in farm bankruptcy cases, reduces the administrative costs to the farmer's estate, precludes the imposition of liquidation plans presented by creditors, and maintains the exemption for farmers from involuntary bankruptcy.

The cost savings come primarily from the fact that the court is allowed to avoid the very high cost of employing attorneys, accountants, and other professionals except where there is a demonstrated need to protect the rights of the creditors. The proposed subchapter authorizes, but does not require, the court to appoint a committee of unsecured creditors if a threshold request for a committee is made by three parties in interest. Appointment of the committee is left to the discretion of the court for cause shown. This procedure preserves assets necessary to run the farm and pay creditors.

The provisions of current chapter 11 provide for multiple creditor committees, permit appointment of a trustee and an examiner, and allow for attorneys and other professionals to be employed by the committees and trustee in the course of a case. These appointments and employment may be necessary and justified in complex business cases, but are not generally appropriate for a farmer's reorganization case where there is most commonly a straightforward need to operate a farm and see to the feeding of stock and the planting and harvesting of crops.

The proposed subchapter restores to farmers protection from involuntary submission to bankruptcy liquidation. Current law permits the farmer or his creditors to file a reorganization plan. A plan may provide for the sale or disposition of farmer assets. The proposed subchapter precludes creditors from presenting a reorganization plan. If the farmer's rehabilitation plan is not accepted by creditors or a viable plan cannot be formulated, the farmer may move to dismiss or he may file under chapter 7.

Under the proposed subchapter, a plan can only be proposed by the debtor. Although the time for filing the plan is not prescribed, the proposed statute does authorize the court to fix a time for filing the plan. The standards for confirmation of a plan have been simplified; the tests of feasibility and best interest have been generalized to permit the courtwide discretion in considering farm reorganization cases.

The new subchapter also permits prompt and expeditious court authorization for the borrowing of funds as an administrative expense where there is an immediate need. Emergencies, such as the feeding of farm stock, often require quick action. A new provision enables the court to authorize obtaining credit without the range of formalities required in commercial business cases.

Mr. Chairman, this new subchapter is designed to fit within the statutory design of the Bankruptcy Code. Many of the provisions of the code remain applicable to farmer cases and provide the structure for the administration of the case. The addition of an agricultural subchapter to chapter 11 within the code leaves the code otherwise undisturbed.

At this point, Mr. Chairman, I would like to enter into the record a section-by-section analysis of S. 705.

I would also like to enter several letters of comment on this proposed subchapter into the record for the committee to consider.

Mr. Chairman, I thank you again for having this important hearing. I urge the committee to consider a new subchapter for farmers under chapter 11. This is a matter of crucial significance at this time because of the critical farm economy, and I know the committee will act accordingly.

Now, Mr. Chairman, this legislation is not a cure-all. It is another tool in the fight for having to save farmers.

As the Senator has just said, 30 percent of the farmers are not creditworthy this day and age, but if a farmer can be saved, he can be bailed out. This is a simplified procedure, allows the farmer to come in and meet with his creditors, offer a plan, and if you accept it, it is all over. And if it is not accepted, he can go back to another section of the Bankruptcy Code. The genius of this plan is that it acts quickly, swiftly, and with little cost. And I think the effort is worth it. I think it is another tool that we need at this time in agriculture.

[The information follows:]

S.705

FAMILY FARM REORGANIZATION ACT

SECTION-BY-SECTION ANALYSIS

§1181 Inapplicability of Other Sections

Section 1181 makes inapplicable those provisions of Chapter 11 which are particularly appropriate for most business reorganizations. In some instances, similar but reworded provisions are substituted within newly proposed Subchapter V. In other instances, such as 11 U.S.C. §1109(a), which allows the Securities and Exchange Commission to be heard, the pertinent provisions of Chapter 11 are omitted as inappropriate to family farm reorganizations. Otherwise, the statutory procedures of Chapter 11 are preserved as are the rights and duties set forth in Chapters 1, 3 and 5 of the Bankruptcy Code, including the family farmer's exemptions.

§1182 Definition

The Bankruptcy Code defines "farmer" at 11 U.S.C. §101(17) as a "person that received more than 80 per cent of such person's gross income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person". The word "person" is, in turn, defined in part as including an "individual, partnership and corporation". 11 U.S.C. §101(33).

By contrast, Section 1182 limits the definition of "farmer" in 11 U.S.C. §101(17) to an individual engaged in a "farming operation", which is defined in 11 U.S.C. §101(18). Subchapter V is therefore limited to an individual farmer.

§1183 Right to be Heard

Proposed Section 1183 allows certain governmental agencies, departments, officials to be heard in a family farm reorganization. Generally, these agencies, departments, or officials are charged with overseeing or administering agricultural programs and with providing information and assistance in the public interest. The proposed Section gives pertinent agencies, departments and officials standing to be heard to protect and implement the programs for which they are responsible. Proposed Section 1183 is similar to 11 U.S.C. §1109(a) which gives the Securities and Exchange Commission comparable rights, but denies it the right to initiate an appeal. Proposed Section 1183 follows existing law in this regard.

Section 1109(b), 11 U.S.C. §1109(b), remains applicable to permit parties in interest, including the debtor, to raise, appear and be heard on any issue in a case under proposed Subchapter V.

§1184 Creditor's Committee

Proposed Section 1184 authorizes, but does not require, the court to appoint a committee of unsecured creditors if a threshold request for a committee is made by three (3) parties in interest. Appointment of the committee is left to the discretion of the court for cause shown. To reduce costs and streamline the proceedings, the statute suggests that committee membership be generally limited to five members, rather than the seven-member committee suggested by 11 U.S.C. §1102(b)(1).

The proposed Section 1183 empowers the court to avoid the expense incident to the formation of a committee.

Frequently, a farmer's creditors may not be interested in forming a committee. This may be particularly true where amounts due to secured lenders are the principal problem precipitating the family farm reorganization.

Committees, once formed, tend to generate costs that are particularly burdensome for farmers. These costs include fees and expenses for professionals retained by the committee as well as transportation and other incidental expenses generated by committee members. Costs so incurred are priority expenses in the case which must be paid before the claims of unsecured creditors. In cases where committee expenses are not justified, they may therefore be avoided.

§1185 Powers and Duties of a Committee

Proposed Section 1185 is similar to existing Section 1103, 11 U.S.C. §1103. To save unnecessary expense, the provision has been altered to establish criteria to regulate and limit appointment of an accountant for the committee. As a further alteration, the committee is only empowered to seek a dismissal of the case if there appears to be no likelihood of successful rehabilitation. Thus, the committee may not seek a conversion of the family farm reorganization to a liquidation under Chapter 7 or to appoint a trustee, as it might in a typical non-farmer Chapter 11 under existing Section 1103, 11 U.S.C. §1103. Otherwise, committee functions under new Subchapter V will be similar to those set forth in existing Section 1103, *supra*.

§1186 Emergency Care of Stock

Proposed Section 1186 is intended to dispense with notice to creditors as a prerequisite to obtaining credit to feed and provide emergency care for livestock. To prevent irreparable loss or damage, the proposed Section permits the court to authorize credit for the feeding of stock owned by, or in the possession of a farmer debtor, without notice or a hearing. Proposed Section 1185 is not intended to affect or dispense with the requirement of adequate protection, 11 U.S.C. §361, which can be provided after immediate needs of livestock have been met. Because the time constraints are not as urgent, the proposed Section does not apply to credit to plant or harvest crops.

§1187 Who May File a Plan

Proposed Section 1187 recognizes that the personal services of the farmer debtor and his willingness to work under the plan will be crucial to a successful rehabilitation of the farmer's financial affairs. Unlike existing Section 1121, 11 U.S.C. §1121, proposed Section 1187 retains in the farmer debtor the exclusive right to file a plan. Creditors and others parties in interest are precluded from filing a plan, or a competing plan, but creditors and other parties in interest may participate with the farmer debtor in the formation of a plan. Thus, current court rulings allowing creditors to file liquidation plans, see e.g. Jasick v. Conrad 727 F.2d 1379 (5th Cir. 1984), and In re Tinsley, 36 B.R. 807 (W.D.Ky. 1984), would not be sanctioned. The farmer, if he wishes, may file or even consent to a liquidating plan.

§1188 Contents of a Plan

Proposed Section 1188 makes available to the farmer all of the benefits and provisions of existing Section 1123, 11 U.S.C.§1123, applicable to plans under

Chapter 11 of the Bankruptcy Code. The proposed Section prohibits inclusion of any provision in a plan which would result in the loss or transfer of all or any part of the family farmer's property without his consent. Thus, the proposed Section provides that the contents of Subsection (a)(5)(A), (B), (C), and (D) of existing Section 1123 can only be contained in a plan proposed or consented to by a farmer. Although only the farmer may file a plan, aggressive tactics by creditors may force unwanted conditions into a plan imposed upon the farmer. The proposed Section makes it clear that the farmer's voluntary consent is a prerequisite to property disposition under the plan.

§1189 Confirmation of Plan

Proposed Section 1189 replaces existing Section 1129, 11 U.S.C. §1129, and simplies confirmation of the family farmer's plan of reorganization. Because creditors of family farmers are likely to be acquainted with both the farmer and his farm and have convenient access to the farmer's schedules and statement of affairs, the potentially costly requirement of a disclosure statement has been eliminated. Similarly, provisions dealing with the issuance of securities, the identity and affiliations of directors and officers, and insiders retained by the reorganized debtor have been eliminated as unnecessary.

While accommodating the needs of the farmer, important creditor protections are maintained. The plan must still be accepted by creditors. 11 U.S.C. §1126. A confirmation hearing must be held. 11 U.S.C §1128. To confirm the plan, the court must find that the "plan is for the best interest of creditors and is feasible". [Proposed Section 1189(4)]. This standard is to be applied within the framework of the Constitution of the United States.

Feasibility is a better measure of a confirmable plan than liquidation value, the standard set forth in Section 1129 (7)(A)(ii) of present Chapter 11. Many farms are valued far below the sum of their debt. Liquidation value is, therefore, not a constructive guide to rehabilitation. By contrast, "feasibility" and "best interests of creditors" as tests for confirmation, will enable the court to approve practical solutions. The tests of "feasibility" and "best interest" have been generalized to give the court sufficient discretion to confirm workable plans.

The phrase "best interests of creditors" and the requirement that a plan be "feasible" were also found in Section 366(2) of the Bankruptcy Act, which pertained to the confirmation of arrangements under now repealed Chapter XI. Under the Bankruptcy Code, Chapters X, XI and XII are all combined in a single chapter, present Chapter 11. It is proposed to add Subchapter V as a part of existing Chapter 11. Under the "best interests of creditors" test, as applied in Chapter XI, the following proposition was considered relevant by Collier: "[W]here it was uncertain that liquidation would result in any appreciable advantage over the composition offer, the composition ... was for the best interests of creditors." 9 Collier, Bankruptcy §9:17, page 282, (14th Ed. 1978).

See also In re Gilchrist Company, 410 F. Supp. 1070, 1074 (E.D. Pa. 1976) where the court states: "The requirement that the Plan be in the best interests of the creditors (§366(2) of the Act) is 'broadly interpreted to require a comparison between what creditors would receive under the composition offer and what they would receive in liquidation of the estate. Where the composition offer would pay creditors considerably less than they might reasonably expect to realize in liquidation, the composition under [§366(2)] was not for the best interests of creditors.' 9 Collier §9.17, at 281 (cases omitted)."

The test of "feasibility" under Chapter XI was "whether the things which are to be done after confirmation can be done as a practical matter under the facts." 9 Collier, Bankruptcy §9.18[1], page 288 (14th Ed. 1978).

Both tests, therefore, protect creditors and promote the rehabilitation of the farmer.

§1190 Conversion Or Dismissal

Proposed Section 1190 authorizes the court to dismiss a family farm reorganization, on its own motion or on the motion of a party in interest after notice and an actual hearing. In determining whether to order the dismissal, the court may be guided by one or more of statutory criteria within the present Section 1112(b) of the Bankruptcy Code, such as continuing loss to or diminution of the estate, or inability to effectuate a plan, or for other cause, whichever is in the best interest of creditors and the estate.

Consistent with existing policy, farmers have long been exempt from involuntary bankruptcy. Conversion to a case under Chapter 7 is therefore prohibited unless the farmer requests such conversion.

WILLIAM A. HILL
BANKRUPTCY JUDGE

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April 15, 1985

The Hon. Quentin N. Burdick
United States Senate
Washington, DC 20510

IN RE: SENATE BILL 705

Dear Senator Burdick:

Thank you for providing me with a copy of S. 705 and illiciting my comments thereto.

Your assessment of the magnitude of the problems facing agricultural debtors is correct. Chapter 11 in its present form is too expensive and too cumbersome for satisfactory implementation by most farmers, and very few are ultimately successful.

S. 705 as proposed is helpful towards simplification of the farm reorganization process. Most helpful is the clarifying language of section 1187 which eliminates the ability of a creditor to file a liquidating plan which they may now do under the holding of the Buttonhook Cattle Company case decided recently in the United States Court of Appeals for the Eighth Circuit. The simplification of the standards for confirmation and the provision for ex parte authorization for the obtaining of credit are also helpful. Although section 1184 does not mandate the appointment of a creditors' committee, almost any case of any significant size would probably require the appointment of an unsecured creditors' committee.

Regardless of the protections available under Chapter 11 of the Bankruptcy Code and the simplification of those procedures, farmers involved in Chapter 11 reorganization face an extremely difficult task due to factors which are not readily controlled by the debtor-in-possession, creditors, the courts or, for that matter, Congress. Factors such as market prices, availability of future operating funds, government programs and weather are, for the most part, imponderables which the business debtor does not face in the same degree or magnitude that a farmer does.

To the extent that the Bankruptcy Code can be a vehicle for farm reorganization, it should be simplified for ease of implementation. S. 705 is quite positive in this regard.

Very truly yours,

WILLIAM A. HILL
U.S. BANKRUPTCY JUDGE

WAH/pam

James R. Jungroth Box 1367, Jamestown, North Dakota 58401

April 17, 1985

Mr. Quentin N. Burdick
United States Senate
Committee on Appropriations
Washington, D.C. 20510

Dear Quentin:

I received your letter of April 4th with reference to the introduction of a bill for a special Chapter 11 for farmers.

This is an excellent idea as the present code really does not fit the situation of a farmer. When we try to put forward a plan, we find it nearly impossible to predict prices let alone the weather so it is extremely difficult to put forward any kind of a plan that makes any sense. What we are trying to do is say "we hope" but I do not believe that fits the test of a plan under the present code.

I refuse to take any more Chapter 11's for farmers inasmuch as even at a fee as high as 10 or 15 thousand dollars you are not paid for all the time you get in it with all the hassling you get from creditors and others.

I can't imagine how a farmer is going to be able to do his reorganization without the help of lawyers, accountant's etc but if it can be done, more power to them.

As I see it, what we need on a Chapter 11 with farmers is a filing with the stay provisions and a very generalized structure for a reorganization plan recognizing the vagarious of weather and prices. If the creditors can get anything and keep the fellow on the land, we ought to try to keep this going.

By the way, FHA are the toughest creditors of all fighting plans at every step of the way and attempting to get the stay lifted so they can foreclose even with the present injunction of Judge Van Sickle in force. They say the injunction can't apply to the Bankruptcy Court or the Court would be enjoining itself. An interesting sophistry.

Yours very truly,

JRJ:dc

James R. Jungroth

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ROGER F. PERSINGER
OF COUNSEL

April 23, 1985

The Honorable Quentin N. Burdick
United States Senator
Committee on Appropriations
Washington, DC 20510

RE: Bankruptcy Bill Agricultural Reorganization

Dear Senator Burdick:

I have reviewed the agricultural reorganization bill sent to me on April 4, 1985, which bill I believe is meritorious.

In reviewing the bill, I do have one comment and that relates to the absolute priority rule contained in §1188(6)(C)(ii), which I believe should be clarified adding thereto that the property received or retained under the plan must have value. The reason for this is due to the fact that the cases have stated that if the owner or stockholder retains an interest in the property, the plan cannot be confirmed whether or not that property has value.

Thank you very much for sending the bill to me and requesting my comments.

Very truly yours,

Max D. Rosenberg

MDR/cah

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April 26, 1985

Honorable Quentin N. Burdick
United States Senator
451 Russell Senate Office Building
Washington, D.C 20510

Dear Senator Burdick:

Thank you very much for providing me with a copy of your Senate Bill 705 to amend Title 11 of the United States Code to aid reorganization of family farms. I believe the bill has considerable merit, particularly in Section 1181 making inapplicable to individual farmer cases some of the more cumbersome and expensive provisions of the Code applicable to reorganization of business enterprises.

With reference to Section 1184, I suggest that the creditors committee should not be limited to "unsecured creditors". My experience in farmer cases indicates that there are usually very few unsecured creditors. Although the interests of secured creditors may be divergent, it seems to me that participation of secured parties in such committee as may be ordered by the court would be appropriate because such creditors ordinarily have the greatest dollar amount at stake. I also suggest it would be appropriate to provide the committee with authority to propose a plan of reorganization for liquidation if a debtor's plan is not confirmed within a period of time after the filing of the petition. The 120 day period included in the present Section 1121 of the Bankruptcy Code is unrealistically short for farmers. As you well know, a farming enterprise functions from one harvest season to another, therefore farmer reorganizations are much more long-term than the ordinary business case. It seems to me that if a farmer has not been able to file a Plan and have the Plan confirmed after two harvest seasons (24 months) the creditors should have an opportunity to recover what they can from remaining assets at least by way of filing a liquidation Plan.

I am extremely concerned regarding the methods employed by farmers in Chapter 11 cases in our area. This concern is generated by the fact that I am likewise concerned regarding availability of essential credit to farming operations. Many of the Chapter 11 cases pending in North Dakota were initiated in 1982-83. A viable Plan is yet to be proposed in most of the cases and I'm aware of only one or two farmer reorganization cases in which Plans have been confirmed. One of the problems is that the farmers are somewhat unrealistic. Rather than waste their time and money in attempting to reorganize a farm hopelessly encumbered with debt, the individual and the economy would often be better served if the party allegedly attempting to reorganize would get on to more productive affairs. Many of the Chapter 11 cases pending in North Dakota at this time are in such a hopeless condition that bona fide reorganization is just not a realistic possibility.

I fully appreciate that the tone of this letter may seem adverse to the "family farmer". Part of this attitude may well be generated by the fact that "family farmers" are not what they used to be. Persons who purport to be family farmers are now filing Chapter 11 for reorganization after their jet aircraft has been repossessed or when there are problems retaining their $100,000.00 combines or other equipment to farm their 8,000 to 15,000 acres of land. An individual such as myself is bound to be somewhat disillusioned with the struggling farmer who files Chapter 11 in November and spends the following month of February in Hawaii. I realize this is not a politically popular position because the farmer has been sacred in America for many years. On the other side of the coin, there are good operators who have not squandered their resources for non-farming purposes who realize that when debt is incurred it must be repaid some time. You do not find many such farmers reorganizing in Chapter 11. Most creditors have now become more realistic and the last thing they want to see is one of their customers in a never ending expensive Chapter 11 proceedings. In the last few months I have found that considerable progress is possible through voluntary out-of-court arrangements.

Our mutual friend Dick Barry stopped in the office a few days ago when he returned from Florida. In that connection, he requested I correspond with you on what he has found to be the lack of economic and social data involving reorganizations under Chapter 11 such as number of employees involved, etc. Barry suggested the possibility of modification of the statement of financial affairs for debtors to include an item to indicate the number of persons employed in the enterprise seeking judicial relief. He requested your input as to whether Congressional action or action by the judicial conference would be appropriate.

I look forward to seeing you this summer and I am honored by your request for my opinion regarding your Senate Bill 705.

Yours truly,

David T. DeMars

DTD:lvd

Box 657 – Jamestown, North Dakota 58401

May 9, 1985

Senator Quentin N. Burdick
Senate Office Building
Washington, D. C. 20510

Dear Quentin:

Thank you for forwarding a copy of your bill creating a new subchapter to Chapter 11 of the Bankruptcy Code. We fully agree with your introductory remarks that amending the bankruptcy code will not by itself solve the farm credit crisis. We do, however, also agree that Chapter 11 of the bankruptcy code is unnecessarily complicated and costly for the traditional family farm unit, and should be simplified.

Earlier this year, we reviewed similar bills introduced by Representatives Mike Synar and Peter Rodino (as recorded in the March 5, 1985 Congressional Record, pages E777-E779). These bills called the "Family Farmer Bankruptcy Reform Act of 1985" takes the other approach of amending Chapter 13 of the bankruptcy code as a means of simplifying the handling of farm bankruptcies.

Upon review of your bill, "The Family Farm Reorganization Act," and comparing it to the Synar-Rodino bills, it appears to us that your bill would be a simpler method of meeting the concerns of family farmers. Your bill would also appear to provide more flexibility and protection for the family farmer, as well as more protection and participation opportunity for the unsecured creditor.

Typically, the family farmer, as a more consistent cooperative patron, is more likely to have unsecured debts with cooperatives. It is extremely important that these unsecured creditors have direct participation in the development of a reorganization plan.

The Synar-Rodino bills would permit farmers with aggregate debts of up to $1 million to use Chapter 13. In our judgment, it would be appropriate to have a limitation on aggregate debt of about $1 million to be eligible for the new Subchapter V of your Family Farm Reorganization Act. The only reference to a debt limitation that we see in your bill is if a debtors' debts exceed $5 million that the creditors committee could select and authorize the employment of an accountant.

It is unlikely that a farmer who falls within one definition of a family farmer would have debts exceeding $1 million, but to be on the safe side, perhaps the eligibility for this new subchapter should be for those farmers with aggregate debts of less than $2 million. Nevertheless, an aggregate debt limitation is necessary if it is to be a Family Farm Reorganization Act.

The Synar-Rodino bills would permit individual proprietorships, partnerships, and limited farm corporations to file under Chapter 13. Your bill limits the use of the Subchapter V provisions to individuals. Considering that many of our farmers who are in difficulty are farmers who have helped their sons or daughters in partnership arrangements, we would suggest that such on-farm family partnerships also be made eligible for this subchapter.

We do fully agree with your bill that farm corporations, whether or not they are limited, should be excluded from your bill. The simple fact is that by their very nature, the so-called "family farm corporations" are larger than family sized operations and are primarily incorporated to avoid taxation of their higher net farm income conditions.

While your bill makes a reference to the definition of a farmer and farming operation, we are not sure whether this is the same definition referred to in the Synar-Rodino bills. Their explanation is that a farmer is defined as a person who receives more than 80 percent or more of their gross income from farming. Synar proposes that a farmer be redefined as a person who receives more than 50 percent of gross income from agriculture.

If the 80 percent gross income requirement is also applicable to your bill, then perhaps your bill should also include a provision redefining a farmer as a person receiving more than 50 percent of their income from agriculture. Because of low farm income and the increasing necessity of both farm spouses to hold off-farm jobs to support their farming operation, such a reduction may be appropriate. However, we also recognize that such a lower percentage may invite bankruptcy filings under this subchapter by off-farm investors. Perhaps appropriate language can be developed which gives the Court some flexible guidelines as to the definition of family farmers and their eligibility for use of the proposed subchapter.

The Synar-Rodino bills amend Chapter 13 permitting a family farmer 270 days, rather than 30 days of filing a plan to begin making payments. As we understand your bill, this would be left to the discretion of the Court to fix a date. We believe that this flexibility in your bill would better serve the interests of the farmer as well as unsecured creditors. This would permit a case-by-case determination based on harvests, etc.

The Synar-Rodino bills would permit modification of mortgaged debt to preserve the farm-home under Chapter 13. We assume that such modification is available under Chapter 11 and your bill.

Your bill contains an important ingredient in not permitting a court to convert the case to a Chapter 7 liquidation, except if such action is requested by the debtor.

Your bill also contains provisions for obtaining credit for emergency feeding of livestock. I do not know whether or not the use of cash or other assets for such emergency feeding would also require court approval under the bankruptcy code. If such approval is required for use of cash or assets (changing the reorganization plan) for emergency livestock feeding, and it is not presently included in the Court's authority, then we would suggest that proper authority be written in for such situations.

We recognize that both your bill and the Synar-Rodino bills are attempting to simplify and reduce costs for family farmer bankruptcy proceedings. It appears to us that an amendment to Chapter 11 would be both mechanically and administratively a more appropriate route. At least I find it easier to understand your route, than the House bills' routing through Chapter 13.

We have to admit that we are not experts in the bankruptcy code, because generally family farmers have found it difficult and costly to use Chapter 11. We sincerely appreciate your expertise in this area, and are confident that your bill would help facilitate the problems faced by family farmers.

In addition to commenting on your legislation, I would-like to reflect a deepening concern among our members. At our last state convention, our members adopted a position stating: "We request a review of the federal bankruptcy laws for the purpose of preventing abuses." This position was taken out of concern over perceived inequities in the reorganization plans, etc. of bankruptcy filings by some of the largest farm operators in the state, as well as difficulties faced by cooperatives as a result of bankruptcy filings by larger producers.

In calling for this review, the Policy Committee's discussions centered around the fact that it appeared that the bankruptcy code offered better protection to extremely large farm operations than it provided to family-sized operators. We are hopeful that your legislation would correct this apparent inequity.

Our Policy Committee also questioned whether or not larger-than-family-sized operators should be eligible for federal bankruptcy protection. It was the Policy Committee's belief that farm bankruptcy provisions should not permit a bankrupt farm operator from maintaining a farm unit that is larger than a family-sized farm operation under any reorganization plan.

They compared the eligibility standards to FmHA borrowers, suggesting that if a larger-than-family-sized farm operator wished to be eligible for FmHA loans, that he should be required to reduce the size of the operation. In the same vein, they suggested that a farm operator wishing to reorganize under Chapter 11 should be required to reduce the farm operation's size under the reorganization plan to a family-sized unit. They felt that since agriculture is unique among the nation's industries and businesses, that federal bankruptcy protection was not appropriate for those who were "high-flyers and speculators" in farming.

While we do not at this time have specific recommendations for such reform, we are interested in exploring the possible ramifications of such an approach. We do not know of any precedent within the bankruptcy laws for such reform, or if such restriction would be achievable under federal law and constitutional provisions. Therefore, we appreciate any suggestions, materials, or advice you may have for such policy direction.

Again, thank you for the opportunity to review your legislation. We know that you share our priority of adequate credit resources for family farmers and the concurrent requirement of increased farm income, but yet, we also recognize the need for reform in the bankruptcy code.

Sincerely yours,

NORTH DAKOTA FARMERS UNION

Stanley M. Moore
President

SMM:jet
cc NFU, Washington, D. C.

Senator **East**. Thank you, Senator Burdick.

I would like to promptly recognize our good friend and able colleague, the Senator from Alabama, Senator Heflin.

Would you like to make a comment at this time?

OPENING STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM THE STATE OF ALABAMA

Senator **Heflin**. I apologize for being late for the hearing, but other business of the Senate does cause some conflicts from time to time.

I am very interested in the improvement of the Bankruptcy Code to provide relief for farmers. We have had testimony in the Agriculture Committee, and I am one of, I believe, only two members of the Judiciary Committee who also serves on the Agriculture Committee. We have heard a lot of testimony about the prices pertaining to farm credit and the Farm Credit System, and what is necessary there to, in effect, bail out the Farm Credit System which is largely a co-op, Federal land banks and the Production Credit Associations and other credit groups and organizations. We find that farming today is in tough financial condition. In my home State of Alabama, farm bankruptcies have increased by 57 percent from 1981 to 1983, and Farmers Home Administration data indicates that in 1984, that 42 percent of all of their loans were delinquent.

Faced with the prospect of an upward trend in farm failures, it would appear to me that we should to review the present bankruptcy laws to see if we cannot endeavor to make changes which will benefit the farmer, as well as benefit the creditors. There are procedures that are available to businesses and individuals that allow them to come out of their credit crisis and, nevertheless, pay their debts, but have the support of the bankruptcy laws at the same time.

There are several bills being considered. I have introduced a bill, and a bill similar to mine has already passed the House of Representatives on June 24, 1985. This is H.R. 2211, and it was a culmination of hearings, discussions, and a continuing study of the farm credit crisis under the leadership of a number of outstanding Members of the House of Representatives. The legislation is a concrete and workable solution to the plight of the American farmers.

Currently, many farmers forced to file for protection under the Federal bankruptcy law must do so under chapter 11 because the amount of their indebtedness, in most cases, is too high to file under chapter 13 provisions. Currently, to be eligible to file under chapter 13, a debtor must have noncontingent, liquidated, unsecured debts of less than $100,000, and noncontingent, liquidated secured debts of less than $350,000. Many family farmers have debts in excess of this ceiling and cannot utilize chapter 13. Chapter 13 is less expensive, quicker, simpler, and more flexible than chapter 11.

My bill allows the family farmer to file when more than 80 percent of his debt has arisen from farm operations. It raises the debt ceiling for family farmers so that a family farmer can file under chapter 13 if the total of the farmer's secured and unsecured debts is less than $1.5 million.

This legislation affords the family farmer flexibility and increases his chances of retaining his farmland while still making payments to his creditors and makes several other modifications in current law. Under this bill, the family farmer is given the right to modify secured debt on the principal residence if the residence is used in connection with farming operations. Because many family farmers live on the land they farm, this is often the largest part of their debt. Under current law, farmers cannot modify this secured debt.

Farmers currently have trouble meeting the 30-day deadline for first payment under the debt repayment plan since farm income is sporadic and tied to seasonal harvest. The presiding judge is provided the flexibility to adjust the 30-day requirement for the debtor's first payment under this plan.

The court is also authorized to provide family farmers filing under chapter 13 up to 10 years to complete their payment. Farmers filing under chapter 11 will also benefit from this bill as the time period for filing a plan under chapter 11 is extended from 120 to 240 days. If no plan has been filed after 240 days, creditors can file their own proposed repayment plan.

Farmers often have difficulty meeting this deadline through an inability to determine how successful their next harvest season will be.

Other proposals have been introduced by my colleagues, Senator Harkin and Senator Burdick, Senator Burdick's bill approaches the problem by adding a new subchapter for the individual farmer under chapter 11 of title 11 of the United States Code.

Our purpose today is to focus on the problems faced by the American farmer and to provide the most appropriate legislative response which allows the farmer to restructure his debt while still retaining his most precious asset, his land, and to enable the farmer to pay his debts.

I realize the decisions we ultimately make will not only affect the farmer but the institutions which have made loans to the farmers. I hope that we can find a common ground, a balance between the business consequences of a bankruptcy decision and the personal realities involved. It is my belief that ultimately we are working toward the same goal, the stabilization of our financial institutions and the preservation of a way of life for the American farmer.

I am delighted to participate in this hearing, and I appreciate the chairman allowing me to make this statement.

Senator **East**. Thank you, Senator Heflin. It is always a pleasure to have you here and to work with you.

Representative Congressman Tauke is here from Iowa, and we are delighted to have him this morning from the other House.

Congressman, we will be delighted to hear from you.

STATEMENT OF HON. THOMAS J. TAUKE, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. **Tauke**. Mr. Chairman and members of both subcommittees, it is a great honor for me to have the opportunity to testify before both of these subcommittees. Thank you, Senator. I appreciate the chance you have given us by calling these hearings, and I commend you for calling hearings on this important issue.

Let me say at the outset that it is very likely my colleague, Congressman Synar, may not be able to appear here this morning. I understand he has an amendment on the floor of the House as well as serving on a couple of conference committees that are meeting this morning. He will try to be here, but if he is not able to be here, I ask that his testimony be submitted as part of the record along with my own.

And with that, I will make a few general comments and then be available for questions.

I think it is important for us to recognize that from a historical perspective, farmers have always made effective use of bankruptcy courts. While, as a general rule, Americans have used the bankruptcy courts on the ratio of 2 out of every 1,000, farmers have traditionally used the bankruptcy courts at the rate of about 8 out of every 1,000. And so consequently farmers have always made use of bankruptcy courts at a rate that is higher than the American people as a whole. Obviously this has been exacerbated substantially over the last several years when we have had record numbers of farmers making use of the bankruptcy courts.

In our own State of Iowa where the value of farm assets has declined about 60 percent since 1981, there are many farmers who are facing very serious financial problems. Thus, it should not be surprising that the number of farm bankruptcy cases in our own State has more than quadrupled over the last 2 years.

It is important also to recognize that we are just at the beginning of this wave of new bankruptcy filings. Information compiled by Iowa State University suggests that in our own State at least 20 percent of the farmers are in a position where they will be very unlikely to survive unless they are able to successfully reorganize. That means that they need to go through some kind of bankruptcy proceeding.

We in the House of Representatives have passed legislation which would attempt to make it easier for farmers to reorganize. We do not suggest that the bill passed by the House of Representatives is the perfect answer to all of the problems. But the measure offered by Congressman Synar, and approved on a bipartisan basis in the House of Representatives, is a very simple bill. It does protect the creditors, and it is a measure which we believe can solve the problem for farmers without doing any great damage to current bankruptcy laws or causing any new complications for those who participate in bankruptcy proceedings. So we commend that measure to your attention.

But beyond the proposal that was approved by the House of Representatives, it seems to me that there is another very important issue which your subcommittee should be aware of, and that is the problem of access to the courts. Once a farmer files for bankruptcy, it is vitally important that his case receive timely court action. Current law requires that a hearing be held with 30 days of a filing or creditors can begin repossessing equipment. Furthermore, once a farmer is in chapter 11 bankruptcy, the court must obviously act before that farmer can carry out his reorganization plan, before he can obtain loans for seed and fertilizer and feed and other operating necessities. His ability to demonstrate the workability of his reorganization plan depends upon his ability to get his crops in the ground and harvested. And this in turn means that he has to have access to the court and the court has to act in a timely way.

Now, I know that all across the Nation there are bankruptcy courts that are clogged. But certainly in the northern district of

Iowa, part of which I represent, the situation is worse than it is elsewhere in the country, and the problem is indeed acute.

The U.S. Bankruptcy Court in the northern district is on the brink of crisis, and only the heroic efforts referred to earlier by Senator Grassley of former Judge Thinnes, and of the court staff and the volunteer judges have kept that crisis at bay. This year, that court, which has had one full-time judge and now has no permanent judges, has 2,310 new bankruptcy court cases filed this year. The largest number of cases filed in any previous year was 1,819. Of that 2,310 cases, 252 are chapter 11 filings, the majority of which are farm related. In addition, the court has 604 pending Chapter 11 filings, well over 500 of which are farm related. The number of pending Chapter 11 filings is greater than the total bankruptcy caseload of all types of most courts. And this court has only one judge while others have three, four, and five.

The northern district court also has 420 adversary proceedings pending. Finally, the two largest bankruptcy cases ever filed in the State of Iowa, the MorAmerican, and the Morris plan filings, are currently pending before this court. Creditors involved with these two cases total over 20,000, many of them elderly and disabled Iowans whose savings are frozen.

Now, the Judicial Conference has in the past recommended a second judgeship for this court, and it is my understanding that later this month, the conference will again recommend a second judgeship for this court. It is absolutely imperative that this recommendation be acted upon as swiftly as possible by the House and Senate Judiciary Committees.

While I recognize the reluctance of these committees to address this recommendation apart from other Judicial Conference recommendations, the northern district court of Iowa's situation is desperate. And the failure to provide this judgeship in a timely way will deny the right of the people of the northern district of Iowa equal access to the relief of the courts.

So, in summary, I say to all of you gentlemen on this panel, that across the Nation we face a problem in ensuring proper access to the courts for farmers who are in need of bankruptcy proceedings, and that is why the House of Representatives passed the bill authored by my colleague who has now joined me, Congressman Synar.

But, in addition, there is another critical problem, and that is the availability of access to the courts to people who live in areas like the northern district of Iowa where the shortage of judgeships is making that access extremely difficult.

[Statement follows:]

PREPARED STATEMENT OF THOMAS J. TAUKE, A U.S. REPRESENTATIVE FROM THE STATE OF IOWA

Mr. Chairman, I commend you for holding this hearing to examine farm bankruptcy issues, and I appreciate this opportunity to testify before you. The severe depression plaguing the Midwest's agricultural economy makes it imperative that we examine our current bankruptcy system for its flexibility and adequacy in meeting the needs of the family farmer who is struggling to stay on the land, to hold on until the economy improves and retain his way of life. He is the backbone of this nation, and we must find ways to help him survive.

Once a farmer files for bankruptcy, it is vitally important that his case receive timely court action. Current law requires that a hearing be held within 30 days of a filing or creditors can begin repossessing equipment. Furthermore, once a farmer is in chapter 11 bankruptcy, the court must act before he can carry out his reorganization plan and obtain loans for seed, fertilizer, feed and the other operating essentials. His ability to demonstrate the workability of his reorganization plan depends upon his ability to get his crops in the ground and harvested, and this, in turn, depends upon timely court action.

Unless swift action is taken to provide a second judgeship for the U.S. Bankruptcy Court for the Northern District of Iowa, farmers filing for bankruptcy in the Northern District may not be able to obtain this timely consideration. The U.S. Bankruptcy Court for the Northern District of Iowa is a court on the brink of crisis, and only the heroic efforts of the now-deceased Judge Thinness, of the Court's staff, and of volunteer judges have kept the crisis at bay.

This year to date, 2,310 new bankruptcy cases have been filed with this court. The largest number of cases filed in any previous year was 1,819. Of that 2,310, 252 are chapter 11 filings, the majority being farm-related. In addition, the court has 604 pending chapter 11 filings, well over 500 of which are farm-related. The number of pending chapter 11 filings is greater than the total bankruptcy caseload of all types of most courts. The Northern District Court also has 420 adversary proceedings pending. Finally, the two largest bankruptcy cases ever filed in the State of Iowa—the MorAmerica and the Morris Plan filings—are pending before this Court. Creditors involved with these two cases total over 20,000, many of them elderly and disabled Iowans whose savings are frozen.

The Judicial Conference has in the past recommended a second judgeship for this court, and it is my understanding that later this month, the Conference will again recommend a second judgeship for this court. It is absolutely imperative that this recommendation be acted upon as swiftly as possible by the House and Senate Judiciary Committees. While I realize the reluctance some members of the Committees may feel in addressing this recommendation apart from other Judicial Conference recommendations, the Northern District Court's situation is desperate. The failure to provide this judgeship will deny the right of the people of the Northern District of Iowa equal access to the relief of the courts.

Along with my collegues Cooper Evans, Berkley Bedell, and Jim Lightfoot, I have introduced legislation, H.R. 2736, to provide a second judge for the Northern District Court, and I urge you to give this legislation your active consideration. However, the crisis should also help us to consider alternatives which may bring even more timely relief, such as appointing a judge for a five-year period. Now is an ideal time to authorize the appointment of a permanent or a five-year judgeship from the standpoint of timeliness, since the panels for the selection process are already in place to determine Judge Thinness' replacement.

In closing today, I want to share with you my profound admiration for the work of Judge Thinness and his staff and my appreciation, on behalf of the people of the Northern District of Iowa, for the willingness to volunteer time and service shown by the many judges who have provided assistance to Judge Thinness and who have filled in since his untimely death. Judge Thomas Wood deserves our special thanks for agreeing to come out of retirement and serve for a period of several months. To provide Northern Iowans with access to timely court action, Judge Thinness regularly worked seven days a week, fourteen hours a day. Judge Thinness' health failed with his collapse on a Saturday morning last spring. That morning, he was scheduled to hold preliminary hearings on more than 100 cases. He returned to work after a period of recuperation and tried to again take on a brutal schedule.

He literally gave his life attempting to ensure that Northern Iowans had access to the relief of his court. Judge Wood and the many other judges who have volunteered to sit in the Northern District, as well as Barbara Everly, the Clerk of Court, and her staff are dedicated to ensuring Northern Iowans have continuing access to the relief of the Court. In taking swift action to provide authorization for a second judgeship, we will be demonstrating that same commitment.

Thank you for your attention.

Senator East. Thank you, Congressman Tauke. And we are also delighted to have with us this morning Congressman Synar from Oklahoma.

Congressman.

STATEMENT OF MIKE SYNAR, A U.S. REPRESENTATIVE FROM THE STATE OF OKLAHOMA

Mr. SYNAR. Thank you very much, Senator, and I apologize for being late. We are working on the budget.

As the Senate debates the 1985 farm bill, I do not need to tell you all about the farm crisis. Let me just take a minute to explain how it relates to bankruptcy.

Farmers historically use bankruptcy more than most. In 1982, 20 out of every 10,000 Americans filed for bankruptcy. However, 75 out of every 10,000 farmers filed for bankruptcy during that same year.

Since then, farm bankruptcies have increased dramatically. For example, in the Plains States, which include Oklahoma, farm bankruptcies have tripled since 1982 to 1984. And it is very likely, I think we will all agree, that that trend will continue. One-third of all the farmers have a debt to asset ratio over 40 percent, and half of that one-third are over 70 percent.

In other words, about 15.4 percent of all farmers are at a point where it is certain they cannot survive without some type of reorganization.

And despite the need for reorganization, it is virtually impossible for farmers to devise chapter 11 plans under current law that creditors will approve.

Now, in the March 1985 issue of the Farm Journal, it tells about an Iowa farmer who offered his major creditors $66,500 more in a chapter 11 plan than the creditor would get in liquidation. And yet the creditor still voted to reject the plan.

Now, the House Judiciary Committee, on which I serve, also received testimony that no farmer successfully reorganized in the middle district of Tennessee during last year. Not one farmer was able to reorganize in that district.

It is critical that the problems of the Bankruptcy Code be worked out soon because, as we all know, the farm crisis is getting worse.

The Farmers Home Administration, which is the lender of last resort, reports that 35 percent of its loans are now deliquent. And Farmers Home has basically quit loaning money.

Finally, I think we are all aware of the Farm Credit System and the crisis that is even making it more complicated.

Very simply, our farm bankruptcy legislation, which I sponsored and passed the House in June, would help tremendously. Before describing the bill, let me emphasize three basic points.

First of all, the bill is extremely simple. It does not attempt to overhaul the Bankruptcy Code or alter existing policies. It just simply takes family farmers who presently fall through the cracks in chapter 11 and puts them in chapter 13 where they belong.

Second, the bill protects farm creditors. The Bankruptcy Code presently ensures that chapter 13 creditors get at least as much in a chapter 13 plan as they would if the farmer were to liquidate, and liquidation is usually the only alternative for farmers seeking bankruptcy relief.

And, finally, and this has got to be very appealing to everyone, this bill does not cost the Treasury 1 red cent, not 1 red cent. Now, is the bill perfect? Of course not. But it enjoyed bipartisan and unanimous support in the House because it provides meaningful help to America's farmers without undercutting the careful balance in the Bankruptcy Code.

Family farmers are basically falling through the cracks of the code and we need to fill those cracks.

And I will be happy to answer any questions with respect to the specifics of the bill.

[Statement follows:]

PREPARED STATEMENT OF MIKE SYNAR, A U.S. REPRESENTATIVE FROM THE STATE OF OKLAHOMA

The Problem

As the Senate debates the 1985 farm bill, I don't need to tell you about the farm crisis. But let me take a minute to explain how it relates to bankruptcy.

- First, farmers historically use bankruptcy more than most. In 1982, 20 out of every 10,000 Americans filed for bankruptcy. That same year, 75 of every 10,000 farmers filed.
- Since then, farm bankruptcies have increased dramatically. For example, in the Plains States, which includes Oklahoma, farm bankruptcies tripled from 1982 to 1984.
- And it is likely the trend will continue. One-third of farmers have debt-to-asset ratios over 40 percent. Half of that third are over 70 percent.
- In other words, 15.4 percent of all farmers are at a point where it's certain they can't survive without some reorganization.

Despite the need for reorganization, it's virtually impossible for farmers to devise chapter 11 plans under current law that creditors will approve.

- The March, 1985 issue of the *Farm Journal* tells about an Iowa farmer who offered his major creditor $66,500 more in a chapter 11 plan than the creditor would get in a liquidation. The creditor still voted to reject the plan.
- The House Judiciary Committee received testimony that no farmers successfully reorganized in the middle district of Tennessee last year.

It's critical that the problems in the Bankruptcy Code are worked out soon because the farm crisis is going to get worse:

- The Farmers Home Administration is "the lender of last resort", but 35 percent of Farmers Home loans are delinquent. Now, Farmers Home has stopped lending altogether;
- Finally, the Farm Credit Bank System crisis only makes matters more complicated.

The Solution

The farm bankruptcy legislation I sponsored and which passed the House in June will help tremendously.

Before describing the bill, I want to emphasize three points.

- First, the bill is extremely simple. It doesn't attempt to overhaul the Bankruptcy Code or alter existing policies. It simply takes family farmers who presently fall through the cracks in Chapter 11 and puts them in chapter 13 where they belong.

- Second, the bill protects farm creditors. The Bankruptcy Code ensures that Chapter 13 creditors get at least as much in a chapter 13 plan as they would if the farmer were to liquidate. Liquidation is usually the only alternative for farmers seeking bankruptcy relief.
- And third, the bill does not cost the Treasury one cent.

Description of Bill

The House-passed farm bankruptcy legislation has four key components which are essential to a workable chapter 13 bill:

1. Defines "family farmer" for bankruptcy purposes (80 percent or more debt farm-related);
2. Makes family farmers with debts below $1 million eligible for chapter 13, regardless of whether they are incorporated, limited partnerships or family owned;
3. Allows farmers to extend their chapter 13 repayment plans for as long as 10 years, and;
4. Allows modification of claims even if they are secured by the farmer's principal residence as long it is used in a farming operation.

In addition, the House-passed bill gives farmers additional time to propose chapter 11 plans; limits trustee compensation in chapter 13 farm bankruptcies; and

Gives farmers a reasonable time to begin making payments under chapter 13 rather than 30 days as required by the 1984 amendments.

Conclusion

Is the bill perfect? Of course not.

But it enjoyed bipartisan and unanimous support in the House because it provides meaningful help to America's farmers without undercutting the careful balance that our Bankruptcy Code represents.

Family farmers have been falling through cracks in the Code and this bill fills the cracks.

I'd be happy to answer any questions you might have.

Senator **Grassley**. Well, we thank both of you for your testimony, and particularly your leadership in this area. And for my part, I particularly want to say thank you to my friend and colleague, Congressman Tauke for being so vocal and out in front on this particular problem that we have in the northern district of Iowa because of more filings, fewer judges, and particularly considering the health and now the death of Judge Thinnes, the particular emergency we have there.

I would direct my questions to one or both of you, and let you folks decide how you want to answer. The first one deals with the definition of family farmer, because I think we all agree that as nebulous as that term is, that is the sort of an entity that we are trying to help here.

What definition would you use, and then would that involve, for instance, size of farm, assets, amount of debt attributed to farming, or anything else you might think of?

Mr. **Synar**. Well, let me respond on the way the House passed the bill.

The House bankruptcy legislation defines family farmer for bankruptcy purposes as 80 percent or more debt farm related, 80 percent more debt farm related.

Second, we make family farmers with debts below $1 million eligible for chapter 13, regardless of whether they are incorporated, limited partnerships, or family owned. So that is how we define farmer for the legislation.

I will tell you that there was great debate in the Judiciary Committee because many of us who are from farm areas realize that the million dollar cap knocks out a lot of people because of the present situation. And I think that the House would be responsive if the Senate wanted to raise that above the $1 million level in order to take care of what we know are family farms that fall above that.

With respect to the definition of family farm, this was the way that we felt we could include most of the people that we would be having to deal with that are really going to be seeking that reorganization.

Senator **Grassley**. The House bill extends the period of time when only the farmer can file a chapter 11 plan from 120 to 240 days.

Inasmuch as some of these farmers are going to be in such dire straits that no amount of time can help them reorganize, there is a concern that an extended period of time will serve only to allow the loan collateral to deteriorate. You have all heard that argument.

Therefore, would you have any objection to also holding periodic hearings to assess the progress that the debtor is making in preparing his plan?

Mr. **Synar**. Oh, absolutely not. In fact, that complaint was lodged by many in the financial community, and I think, your suggestion is an adequate response to that complaint. And I think that would be perfectly all right.

You know, we are not trying to give these people a free ride. It is going to be very tough to qualify for this type of reorganization. But if they do get qualified for reorganization, we would seek that we could preserve those assets because then we would accomplish the second goal of the legislation, which is to protect the creditors too.

Mr. **Tauke**. I think it is important to recognize that we do have limited assets in the agricultural community, and it is very important that you not waste those assets. And, therefore, I think the kind of review that you suggest is certainly appropriate.

At the same time, however, the thrust of this effort should be to try to ensure that those who do have a chance to reorganize and make it have that opportunity.

Senator **Grassley**. I think because of your leadership in this area, we ought to have for the record your reaction to the arguments that we are probably going to hear from the credit community. The witnesses will state that farmers are businesses, that they are not like individuals for whom chapter 13 is aimed at; that they do not have a steady income; that they need bridge financing to keep going between harvest; and that for all these reasons, it makes it very unwise to try to shoehorn this class of businesses into chapter 13.

Mr. **Synar**. I think I can respond very simply to that.

You know, what we are doing by this legislation is simply saying this, that we are not going to make farmers and ranchers and people in agriculture second-class citizens in this country. Small businesses can reorganize, major corporations can reorganize, individuals can reorganize. But because of the way the bankruptcy code defines "farmers," farmers and ranchers do not qualify for relief that is available to everyone else. This legislation remedies that. It says we are not going to give you a better deal, we are going to give you the same deal that everyone else has, whether you are a small business, a corporation or an individual.

Senator **Grassley**. OK.

Last, for my part, and then I will go to my colleagues, and I would direct this to you, Representative Synar because of your bill, I would like to know the extent to which you focused on the impact that the bill would have on others in the farm community, such as rural banks, fertilizer dealers, farm implement dealers, seed companies, you know, all the other people that are agribusiness firms that are so directly related to agriculture, and probably have a very strong stake out there in what we do with this legislation.

Mr. **Synar**. I think you hit it right on the head. There is a strong stake for everyone in the community, whether it be the adjoining farmers or the small business. Because what is occurring in this country is the domino effect in its purest form.

If a farmer is foreclosed upon, the equity value of every farm adjoining that property goes down, therefore causing more collateral to be called in. It has a collapsing effect and can have severe impacts on the county. That in turn has an impact on most rural communities where small businesses are dependent upon the vitality of agriculture.

In order to stem this domino effect, we need to stem the foreclosures on those farms that can make it and can show that they can make it. By doing that, we protect the equity value of everyone else in the community, therefore protecting small businesses, bankers and the community itself. So this legislation has a tremendous impact on the whole vitality of a community, whether it be other farmers and ranchers or other small businesses.

Senator GRASSLEY. I do not argue with your rationale, but I think it leads us to the ultimate question, which is how likely are others to be paid off then under your bill as opposed to other approaches?

Mr. SYNAR. I think that there is an excellent opportunity because for someone to quality for reorganization, they have got to show that over the period of time that we granted that they will indeed pay back their creditors.

My question to those who oppose the bill, would you rather have 10 cents on the dollar and collapse the whole agricultural system of a particular area or would you like to work the problem out and guarantee that you get a hundred cents on the dollar back, but it will take a little bit longer?

Now, most rural banks, most rural communities know the vital importance of agriculture, and they know that if they can help work through these problems, in the long run it is going to be the best thing for them.

So what we are asking them for as creditors is say you want 100 cents on the dollar, give us a little time, and you can get that versus foreclosing and only getting about 10 cents on the dollar and collapsing the whole community with it.

Senator GRASSLEY. Thank you.

Chairman EAST.

Senator EAST. I would defer to Senator Heflin.

Senator GRASSLEY. OK. Senator Heflin.

Senator HEFLIN. You mentioned that your House bill, I believe, had a limit under the chapter 13 provisions of $1 million of debt, and I believe the Senate bill has $1½ million.

Is $1½ million adequate? You raise an issue of whether or not that is adequate. Farm machinery, of course, is expensive and depend on what type of commodity you farm. Some types of farm machinery and the debt that goes into farming is financially intensified on an acre basis, depending on the crop. In other words, cost of production of cotton is much higher than the cost of production of wheat or soybeans. There are other types of commodities in which the costs are even higher.

We have looked at some small farmers in a small farm of maybe 400 or 500 acres. He may well have an annual investment that is $500,000 or close to $1 million. From a viewpoint of acres, this is a small farm compared to other farms.

You mentioned this, it was interesting to me, do you feel that maybe $1½ million is a proper limit or should it be higher?

Mr. SYNAR. Well, I tend to believe that we have got to go higher than the million where the House was. Let me tell you how we got there.

The Judiciary Committee of the House has all city slickers except for about two of us, and $1 million sounded like a lot of money to most of them, even though I do not think they could really place in perspective what $1 million worth of farm was.

Most of the bankruptcy judges and other experts throughout this country that we have consulted have told us that the figure they would like to see would be $2 million. They think that that would take care of most of the problems.

I think $1½ million is probably a good compromise and I think that the House would probably recede to that position pretty easily. But I think $1 million is too low. I will be candid with you. But we do not want to get it so high to where the politics start cutting against you and more criticisms come from creditors that we have included a group of people that may not necessarily should have qualified.

Senator **Heflin**. I know very little about rice production and that sort of thing, but it is rather surprising to me that on the question of payment limitation of $50,000 on deficiency payments where the target price is involved, that the figures indicated by rice farmers were that a rice farmer with about 150 acres would draw the maximum amount of 150 acres, because of the capital intensified cost of production. But a wheat farmer, in order to draw the maximum amount of deficiency payments—of course they vary—would have to be nearly in the neighborhood of 1,500 acres, depending on farmers and their types. There are certain types of farmers in the West that I know very little about that raise raisins, for example, or that may raise other types of crops that may have a highly cost intensified cost of production. And that means they may have to borrow more money.

It may well be that we want to look at this figure and put some type of limitation, and it may well be that for certain types of farmers, that even $1½ million might be inadequate to take care of the concerns of the small farmer.

Mr. **Synar**. I agree with you.

Senator **Heflin**. That is all.

Senator **Grassley**. OK. I have no further questions Chairman East.

I thank each of you gentlemen and I hope that you will keep in touch with us through the next hearing, and beyond as we consider this legislation.

Now, I want to go out of order, because we have to rearrange our schedule to accommmodate one of the witnesses who needs to catch a plane.

At this point I would like to call Harry Dixon forward. Mr. Dixon is an attorney with the law firm of Dixon, Dixon & Minnahan in Omaha, NE.

Mr. Dixon, I thank you for coming today. I also want to say to you that just in case Senator DeConcini does not and evidently his schedule does not allow him to come, he wanted to welcome you as well. I would state for the record that you are the chairman of the Board of directors of the American Bankruptcy Institute; it is also my understanding that Senator DeConcini is an honorary chairman of ABI, and he was going to take advantage of that relationship with you to come here and introduce you.

So would you proceeding with your testimony.

STATEMENT OF HARRY DIXON, ESQ., OMAHA, NE

Mr. **Dixon**. Thank you, Mr. Chairman.

Mr. Chairman, I am a practicing bankruptcy attorney. My home is in Omaha, NE.

In recent years, a large part of my practice has been in the area of agricultural bankruptcies. It has been a real experience for me. Little did I realize when I served here as minority counsel to the Judicial Improvements Subcommittee and struggled with the definition of farmer back in 1978, how important it would become to me.

In my practice, I largely represent farm lenders or other farm credit extenders. I have represented from time to time many farmers and ranchers in financial difficulty. Notwithstanding the testimony you heard earlier, our firm has confirmed numerous chapter 11 plans of reorganizations for farmers and ranchers.

Today what I would like to do for you is to highlight for the committee some of the burning issues in agricultural bankruptcies and comment briefly on the pending bill.

The majority of agricultural bankruptcies today are chapter 11 filings. From the lenders standpoint, those people that I most often represent, there are some concerns.

One, debtors are able to stall foreclosure proceedings by filing bankruptcy. Many months may have been spent in foreclosure and many costs incurred. These bankruptcy filings often come right at the last minute, literally moments before the foreclosure sale is to take place.

Let me suggest to the committee that in this area of these last minute filings, if the committee would consider some legislation that would define what is good faith. Defining what is a good faith filing under the Bankruptcy Code might help solve some of these problems.

The chances of a debtor being successful in chapter 11 are very remote. I have heard judges say only 1 in 10 cases confirm a plan at best.

Lenders are concerned that collateral is mistreated or allowed to become exhausted during the bankruptcy case, an already bad situation becomes worse. I have seen this happen in many cases today. I think what we are seeing out there in the farming community is a lot of desperation. Two or three years ago, the farmers that we saw were more likely to properly take care of their cattle even in very difficult circumstances. That is not necessarily the case today.

Chapter 11 does not create money. There is no credit created just because a chapter 11 case is filed or, for that matter, any bankruptcy case.

Many lenders think the Bankruptcy Court is debtor oriented, and plans can be confirmed that force the lender to accept terms that the farmer could never obtain in the marketplace. Cases go on and on and there is no conclusion. The lender cannot force the case to be converted to liquidation because of the bankruptcy law. That is a historical problem that came out of the 1930's. Let me specificially suggest to the committee that section 1112(c) of the Bankruptcy Code be amended so that these kinds of cases can be converted from chapter 11 to chapter 7 if the court is so inclined.

From the farmers' standpoint, the concerns are just as great.

The farmer cannot use the money from the sale of grain or other collateral during the case without the lender's permission or the court's approval. That approval can take a long time to obtain, if at all.

The chapter 11 case takes a long time itself. And if the farmer does not file his plan within 120 days, the creditors can file a plan which can provide for the liquidation of the farmer's assets. Let me say I support this. For those cases that are hopeless, the only way that we currently have as lenders' counsel in order to get these cases concluded is to be able to file a creditor's plan of reorganization.

What I see, gentlemen, as the most burning issue today in chapter 11 cases is the ability of a plan of reorganization to give land for debt. Let me give you an example.

The farmer has 2 farms, each of 500 acres. The land is worth $500 an acre, and he owes the lender $500,000. The lender most likely has a lien on both those farms. The question is whether the plan of reorganization can take 500 of those acres, give it to the lender in full satisfaction of the debt, leaving the other 500 acres free and clear so that the farmer can go and farm the next year, or pledge that farm to some other lender in order to raise money in order to farm. That I think is the most burning issue today. It deals with the question of what is the indubitable equivalent within the meaning of the language of section 1129 for confirmation.

The chapter 11 process is expensive for the farmer, and only the attorneys seem to be making any money in the process. It is not unusual to see attorneys request a $15,000 retainer in order to file a chapter 11 case for a farmer.

The courts are not sufficiently flexible to confirm plans that contemplate future commodity prices, at least so farmers think. These kinds of things are difficult to predict. They raise a real question of whether any farmer's plan can be feasible.

Plans do not reduce interest rates. That is one of the reasons that farmers have filed chapter 11, and yet plans do not really do anything about that.

Some legislative assistance in the areas as to what is a fair interest rate for a farmer to pay in a chapter 11 case or, for that matter, any other chapter case would be assistance.

Let me comment just briefly on the pending bills. There has been some discussion already of S. 705 that is pending before the committee. I am concerned with section 1186 of that bill that would create a subchapter for farmers. I am concerned about that part that creates emergency care for stock. It is true that we have that kind of a burning problem of getting care for stock in cases. The solution is not necessarily to go out and give credit without noticing a nearing, to apprise current lenders who might be willing to supply that credit an opportunity to be heard.

Section 1187 of the bill would permit only the debtor to file a plan of reorganization. As I have mentioned to the committee, I do not believe that is fair. I think the creditors ought to be able to file plans of reorganization and terminate some of these cases that are hopeless.

I am in general agreement with section 1189 of this confirmation standard. But I mention to you again that indubitable equivalent, which is the language of the statute, is far too vague in the farm cases that I have experience with.

Let me briefly testify on the chapter 13 approach. I think there are a lot of problems and concern for chapter 13. Chapter 13 is designed for wage earners. It is not designed for farmers. I think the automatic appointment of a trustee in a chapter 13 case is a real problem. It is costly and it is unnecessary. I am concerned about what is going to happen to unsecured creditors in a chapter 13 case. Only the liquidation value has to be paid in a chapter 13 case, not what would have to be paid in a chapter 11 case. These people are fertilizer dealers, feed dealers, seed dealers, sometimes undersecured lenders. They are going to get hurt the most in a chapter 13 case where they would be protected in a chapter 11 case. They are disenfranchised. They do not get a chance to vote upon the plan in a chapter 13 case like they would if it were in a chapter 11.

Problems that exist in a confirmation standards are still going to be present in chapter 13 or chapter 11. I would generally conclude that I am opposed to a chapter 13 approach.

All of these competing concerns are brought before the bankruptcy judges which incidently receive far too little credit for the work they do. Judge William Thinnes of the northern district of Iowa was a fine example of our dedicated bankruptcy bench. Part of the problem of agricultural bankruptcies would be solved if we could just have more bankruptcy judges to handle these cases.

This concludes my formal statement. Thank you, Mr. Chairman.

Senator GRASSLEY. Thank you very much.

I would defer to you for first questioning if you would like to.

Senator EAST. No. Go right ahead.

Senator GRASSLEY. Mr. Dixon, are there any ways to make chapter 11 less complicated or streamlined so that farmers can take advantage of it to a greater extent?

Mr. DIXON. I think there are. I think again—now a lot of it is the number of judges that we have. If we have more judges, chapter 11 cases would be speeded up. Farmers do not have to wait 120 days to file a plan in a chapter 11 case. They normally take that much time because they want to see what the next crop year is going to look like.

And so streamlining it is not so much oftentime from the farmer's standpoint does not mean less time. He usually wants more time. He wants the chapter 11 to last a long time giving him some protection from his creditors during that period of time.

I think streamlining it in the area of confirmation standards is probably the area that could use the most work. Some of those things I talked to you about giving land for debt and discussing those sorts of things that could go in a plan would be very helpful.

Senator GRASSLEY. With respect to that last point you made about the giving of land for debt, have you considered the tax consequences as a result of that as well?

Mr. DIXON. That is a real problem. I know there is legislation pending before the Senate on that. That is just a terrible——

Senator GRASSLEY. Have you had a chance to—I authored that legislation. Have you had a chance to review it to feel if that takes care of a large share of your problems in that area?

Mr. DIXON. I think it would, Senator. It would be very helpful.

Senator GRASSLEY. Our next question would deal with your view on whether it is possible to limit the creation of creditors' committees or put some sort of limit on attorney's fees and from your standpoint, limiting attorney fees is probably raising a red flag. And I do not necessarily suggest it but I think we ought to be looking at all alternatives, and so I would like your comment on those two.

Mr. **Dixon**. I think, first of all now, all attorney's fees have to be approved by the judge. They have to be approved by the court. So the court gets a chance to pass upon all attorney's fees as to whether they are reasonable or not in the case. That is a real cap, and a lot of judges do not allow all attorney's fees that might be applied for.

So I really do not think there is anything that needs to be done in the area of attorney's fees per se.

What was the first part of your question?

Senator **Grassley**. Whether we could limit the creation of creditors' committees.

Mr. **Dixon**. Creditors' committees are not really active in chapter 11 farmer cases anyway. They really are not active. It is just the opposite, trying to get the creditors' committee to be active is a real trick. So I so not think that that is a real burden on the farmers' estate in present chapter 11 cases.

Senator **Grassley**. I would like to ask you about liberalizing the cram-down rules for family farmers.

Mr. **Dixon**. That is what I was trying to discuss when I was discussing about giving land for debt. That would be a liberalization of the cram-down rule to say to a lender the lender has to take the land back. He cannot go foreclose, he has to take it back as part of a chapter 11 plan.

The other thing would be the interest rates. You could come up with some sort of a standard that would say that the court has the ability to look at what is a fair interest rate which may be, in certain circumstances, the contract rate. That would be very helpful in farmers' type reorganization.

Senator **Grassley**. It might be helpful for us if you could give us some suggested language to define how the term "indubitable equivalent" that you already referred to?

Mr. **Dixon**. Be glad to. If I could submit that later for the record.

Senator **Grassley**. Yes. We would want to study your response to that. But you might be of real help in that area.

Mr. **Dixon**. Be glad to Senator.

[Information follows:]

United States Senate
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WASHINGTON, DC 20510

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November 19, 1985

Mr. Harry Dixon, Esq.
Dixon, Dixon, and Minahan
1 First National Center
Suite 1900
Omaha, Nebraska 68102

Dear Mr. Dixon:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 6, 1985 concerning farm bankruptices.

Your response by December 2, 1985, to the following questions would be appreciated:

1. A few bankruptcy courts have interpreted section 552(b) so as to release some property of the farm-debtor from the reach of security interests, thereby transmutting the proceeds from the sale of such property from cash collateral to simply cash for the debtor's use. *See*, *In Re Lawrence*, 41 B.R. 36 (Minn. 1984); *In Re Ydola Pigeon*, 13 B.C.D. 107 (N.D. 1985) (milk); *In Re Hamilton*, 18 B.R. 868 (Colo. 1982) (crops). Are these results fair and reasonable? Would it be wise to specifically incorporate the results in these cases into the Code?

2. I'm interested in your suggestion, made at our November 6 hearing, of allowing farmers to "trade land for debt". How might we amend the bankruptcy code to encourage this? What sections of the Code are implicated? Would you require the trade to be "even", or on a "dollar-for-dollar" basis? Please elaborate, using examples.

3. It's been suggested that courts are misinterpreting the term "adequate protection". *See*, *e.g.* *In Re Dibbern*, B.K. No. 84-1202 (1985); *In Re American Mariner*, 734 F.2d 426 (9th Cir. 1984). Do you agree with the interpretation in these cases. If so, why? If not, how might you define "adequate protection" in a way that is fair to both farmers and creditors?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck Grassley
CHARLES E. GRASSLEY
Chairman
Subcommittee on Administrative
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Charles E. Grassley, Chairman
Subcommittee on Administrative
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United States Senate
Washington, D.C. 20510

February 3, 1986

Dear Senator Grassley:

This letter concerns your correspondence of November 19, 1985.

As to your first question, I do not believe cases such as In re Lawrence, 41 B.R. 36 (Minn. 1984); In re Ydola Pigeon, 13 B.C.D. 107 (N.D. 1985); In re Hamilton, 18 B.R. 868 (Colo. 1982) represent fair and reasonable results. Accordingly, I would not advise that those specific results be incorporated in the Bankruptcy Code.

You also inquired as to an example of my proposal that farmers be allowed to "trade land for debt". This office has confirmed a Plan in which the debtor proposed to convey 480 acres of land to the first mortgagee as the indubitable equivalent of creditor's claim under 11 U.S.C. §1129(b)(2)(A)(iii). The Bankruptcy Court found that the value of the land was $336,000. The Bankruptcy Court made deductions for a grain bin and dryer which was secured by another entity and a 5% sales commission and a credits for the Federal Land Bank stock which was being cancelled and for the real estate taxes which the debtor would pay for a total value of $334,625. The first mortgagee had stipulated that its claim was $312,196. In addition, the Bankruptcy Court found that the mortgagee would save the time and expense of a mortgagee's foreclosure suit. However, on appeal, the District Court noted that the Bankruptcy Court had failed to take into consideration the evidence that the value of the land was decreasing at least 1% a month and that the mortgagee would not be able to sell the land immediately.

Your final question concerned my definition of adequate protection which is fair to both farmers and creditors. I would say that adequate protection is enough protection so that the lender's collateral is not seriously depleted; but, not so rigid a concept that the Court cannot permit a farmer who can be reorganized to operate. As an example of this, I have, in the past, proposed that a creditor with a lien on the dairy herd and an assignment of the milk checks, is adequately protected if the proceeds of the milk checks are used to maintain and increase the value of the dairy herd.

Very truly yours,

Harry Dixon

Harry D. Dixon, Jr.

2286A/jdl

Senator **Grassley**. Chairman East.

Senator **East**. I have no questions.

Senator **Grassley**. Senator Heflin has gone. This would be a good time for me to make an announcement that would apply to every witness. Since people have to come and go from these hearings, you may receive questions in writing. If you do, I would suggest, that if you could get those responses back to us in 15 days from the date of the request, we would appreciate it. You may not get any, but if you do, we would want you to understand that these questions and answers are a part of the record, as much as what we ask here orally.

Mr. Dixon, thank you very much, and I hope you are able to make your airplane.

Mr. **Dixon**. Thank you, Senator.

Senator **Grassley**. It is an honor for me now to call, as a next witness, Richard Stageman, and the reason it is an honor is not only because he is an outstanding judge for the southern district of Iowa, but because I also had the benefit of his counsel and his cooperation many a year ago, I think now 25 years ago when I served with him in the Iowa Legislature. I think your first year was 1961, is that right?

Judge **Stageman**. Pretty close.

Senator **Grassley**. My first year was 1959. But regardless of exactly when it was, I had a very good relationship with him at that time. He was an outstanding State legislator, and you have since established yourself in this position you are now in.

We welcome you here and we welcome your testimony. Let me state for everybody, I think here is a person that I would want all to pay attention to from the standpoint of not only his expertise in bankruptcy law, but he can shine specific light onto the special problems we have in my State.

Judge Stageman.

STATEMENT OF HON. RICHARD F. STAGEMAN, BANKRUPTCY JUDGE, SOUTHERN DISTRICT OF IOWA

Judge **Stageman**. Thank you, Mr. Chairman. Thank you for asking me to submit my appraisal of Senate bills 705, 1342, and 1516.

I have prepared a statement that I would request be entered into the record.

Senator **Grassley**. Let me make a comment on that statement. It is a long statement. I know you put a lot of work into it, and I want to thank you for doing that. And from my reaction from looking at it, it is that you put a great deal of thought into it, and I know that you did not come lightly to present your views to this committee.

Judge **Stageman**. Thank you.

It seems to me that I have always been a bankruptcy judge, having been appointed in the spring of 1962. Over these past 24 years, I have administered nearly 44,000 estates. How many trials and hearings will never be known.

My thesis today is that if amendments to the Bankruptcy Code are being proposed as a part of the farm crisis solution, they are misconceived and misdirected. However, if Congress is bent on special farm debtor legislation, it should be by way of a temporary adjustment in chapter 11. My concern is with the recruitment of the bankruptcy courts as an expedient savior of the family farm and a makeshift guardian of a way of life.

In the southern district of Iowa, to resort to chapter 11 for reorganization of the farm operation is really on the wane in the last few months, and properly so. Chapter 11 was designed with the merchant and the manufacturer in mind. It was designed to give breathing room to these types of enterprises beset by an adverse event or a series of nonrecurring events. Unfortunately, the financial stress farmers are experiencing is not tied to a specific event or series of generally nonrecurring events. The temporary breathing space offered by chapter 11 is of no avail in today's farm economy unless the debtor operates a well-managed farm, can inspire creditor cooperation, and has a core of productive assets.

The cases we are getting are hopelessly burdened with debt, with no free assets on which to structure a reorganization. It is like trying to resuscitate a dead horse. Chapter 11 is for the restructuring and not for resurrecting.

Two very high hurdles face every farm chapter 11. First, gaining the use of cash collateral and standing off attempts to lift the automatic stay against foreclosure and replevin.

Second, achieving confirmation over a few large but unsecured creditors and satisfying the strict priority rule of cram-down. None of the legislation proposed today meet with these principal drawbacks to any meaningful degree. The proposed chapter 13 legislation blurs the distinction between chapters 11 and 13. The differences pointed out by Professor Kennedy in testimony before the House make sense in the mercantile setting but have no currency in the agricultural setting. There are really two distinctions that are valid between 11 and 13 for the mid-size farms. But both of these distinctions will be very susceptible to abuse. First, the more liberal cram-down of the present 13 can allow forgiveness of large amounts of debt. Deep composition plans of 10 percent or less are permitted in most circuits. Second, a discharge by way of plan completion or hardship leaves the lender victimized by a dishonest debtor without remedy. They will be left with only their eyes to cry with.

The proposed chapter 13 amendments have no practical value, they prejudice creditors, they place a burden on the courts, they cannot hear as now constituted. By singling out the family of a mid-size farm, they defeat the purpose of the 1978 chapter 13 meant to effect changes in consumer bankruptices and their relation to wage earners or the mom and pop store, and they corrupt the concept of the Uniform Bankruptcy Code for the United States. Chief Judge Connelly of Minnesota agrees with these conclusions.

As for S. 705, it does not cover a wide enough range of factual situations or legal considerations. Its departure from the fair and equitable rule is probably unconstitutional and its treatment of administrative priority will chill farm trade credit.

If Congress insists, I believe constitutional changes can be made in the context of chapter 11, that will overcome its present faults as regards our farmers.

I will try to answer any questions you may have.

I might add one thing, if I may, Senator. I tell you why you cannot do a 13 in our system as it is today. The northern district's load is horrendous but for 25 years mine has been larger. This is Monday's calendar, it is 14 pages long and most of it is farm.

In the week of September 29 of this year I held 234 hearings in two different cities 200 miles apart. That means no lunch, no supper. It is just too much to shove these 13's on our court system. It will not work.

[Statement follows:]

STATEMENT OF RICHARD F. STAGEMAN

On S.705, S.1342, S.1516
November 6, 1985

> "I will admit if you start reading all of the sections of the bankruptcy law that you reach a state of great intellectual confusion."
> Senator Sam J. Ervin, Hearings on § 976 and § 1912, Before the Senate Committee on Finance, 89th Cong., 1st Sess., 23 (1965).

Mr. Chairman, thank you for asking me to submit for your consideration my appraisal of Senate Bills 705, 1342, and 1516.

It seems to me that I have always been a bankruptcy judge. I was first appointed in the Spring of 1962. Over these last nearly 24 years, I have administered nearly 44,000 bankruptcy estates in Iowa and Nebraska. This overshadows any other credentials I may have that would justify my presence here today so I need not afford the Committee any other qualifications I might have.

I would venture to say that over my years as a bankruptcy judge I have heard more farmers, county seat bankers and farm suppliers testify than any bankruptcy judge ever. I cannot count the instances when I have witnessed adult, selfcontained, weathered men, give testimony punctuated with despairing sobs. There have also been too many nights that I have laid awake with tears in my own eyes reflecting upon the day's proceedings.

I was a hired hand for a dollar a day and room and board in Nebraska at age 14. My boss later became one of Nebraska's directors of agriculture. Without going into further personal detail I can say that I have a direct personal interest and acquaintance with the decline in farmland values, farm income and the attendant farm failure. I am a "family farm" advocate.

The displaced farmer is not a blue collar worker who is laid off. He is not an executive let out. He is not a merchant fallen on hard times. He is not a manufacturer without a market for his widgets. These latter unfortunates suffer, but usually temporarily, in transit to like labor, trade, business position or enterprise. The established land holding middle aged farmer whose life began on the farm, whose family is a part of it, who has lived it twenty four hours a day for twenty years, who has never considered any other life, faced with its loss feels that this is the end for him and his. You don't see in the newspaper personal ads "position wanted, farmer."

In 1985 there have been 387 farm bankruptcies filed through October 29 in the Southern District of Iowa. Farm filing statistics over the past six years are set out in an addendum attached.

My experience in other districts handling farm cases and discussions with my colleagues in the Eighth Circuit lead me to believe these figures are representative of this area of the country.

In reaching the conclusions that follow, I have not just drawn on my own experience. I have consulted with bankruptcy judges in neighboring states. They agree with my assessment. I have also received opinions from members of the Iowa State Bar Association's Committee on Bankruptcy and county seat practitioners. They also support my beliefs.

It is my thesis that if amendments to the Bankruptcy Code are proposed as a part of the farm crises solution, those changes should be made within the framework of Chapter 11. I therefore offer the following hypothesis, reasons and conclusions on the necessity and value of the legislation under consideration.

The financial problems that now grip our farm economy have received a blizzard of publicity in the last two years.

Typically, the coverage has focused on human physical dislocation, emotional suffering, and adverse economic fallout that attend the financially overburdened farmer. Movie and media accounts of farm bankruptcies and foreclosures starkly portray the struggle some farmers presently face in particular, and dwell on the plight of agriculture in the United States in general. The accounts and comments either offer no solution or at least any rational solution, and public debate has degenerated into hand wringing and finger pointing. As for myself, I could not provide any semblance of a solution. That is quite beyond my capabilities, and I am certainly in no position to point a finger. My concern is with the possible recruitment of the bankruptcy courts as an expedient saviour of the "family farm," and makeshift guardian of a "way of life". Before considering the advisability of such stopgap solutions, I should try and state my understanding of the underlying problem.

The immediate problem is that the assets in our agricultural economy do not generate sufficient revenue to service the debt that encumbers these assets. The existing debt load is a product of the immense change that occurred in the agricultural sector over the past 50 years. The most significant element of this change has been in the method of financing the modern farm operation.

Over these years, the Farm Credit System, federal programs of assistance and the private lending sector have generated the outside capital that farming now demands. The importance of this source of funds cannot be overemphasized. Still, these helpful and attractive sources of capital may have, for some, become too helpful and too attractive. In the heady times of the early and mid 70's, commodity prices were up, exports were up, harvests were bountiful, and land prices were rising.

In that prosperous era for U. S. agriculture, farmers' production and investment decisions were often made, and willingly financed by creditors, on the assumption that inflation would continue and that foreign markets for U. S. commodities would continue to grow.

This "borrow as we buy" philosophy worked well as the inflationary growth in asset values outstepped the rate of debt accumulation. We now recognize that too many farmers and lenders equated an appreciation in asset values with an unquestioned ability to service an ever larger debt load.

In the last five years asset values have declined, export markets have shrunk, and harvests have been sub-normal. The only remnant of the 1970's is the huge debt load. Thus, the farmer emerging from the 1970's is highly leveraged and simultaneously confronted with a cash flow shortage and an erosion of equity. The adventurous farmer who is over-extended to formerly indulgent lenders not only lacks a source of much needed additional capital, but also is burdened by an inability to service existing debt. No credit, no cash, a planting season ahead, feed stocks low, suddenly, it is desperation time in Dallas County.

The degree of leverage and the erosion of equity would not present insurmountable problems if a farmer's assets were capable of generating sufficient revenue. The problem of course, is that at existing commodity prices, a farmer's revenues are often woefully insufficient.

The inadequacy of existing commodity prices is a product of the fundamental cause of agriculture's present stress, the ability to produce. In short, there is an excess supply of commodities and an excessive ability to produce commodities. There is too much land under cultivation worldwide producing too many bushels for too few effective buyers.

Given the technology that exists worldwide (it is revealing to note that India is now a net exporter of agricultural commodities), it is inescapable that the nation no longer needs farmers in the numbers once required. It should not be a startling revelation to anyone with even limited foresight that the promises of new techniques of food production, bio-engineering, and laboring robots will at some point be fulfilled. These developments will further displace the "farmer," the "tiller of the soil" as society has known him. The forces of change have been in motion for some time.

The sudden concern for an exodus from the land, the waning of the "American Gothic" is anachronistic, and shows a lack of awareness of recent history. In the July issue of Atlantic Magazine, Gregg Easterbrook points out: "Much is made of the fact that the number of United States farms declined by 33,000 in 1982 and 31,000 in 1983. But the declines were far bigger in the 1950's and 1960's - a period enshrined in political mythology as better for farmers. In 1951 the number of farms declined by 220,000; in 1956 by 140,000; in 1961 by 138,000."

Still, there exists great concern for the number of farmers and farm families who are losing their ownership interest in farmland. The past achievements of the farmer, the state of our world economy, and the acceleration of technological developments press us to make difficult choices. Agriculture has come to the fork in the road. We must either accept the current restructuring process, or enact a revolutionary farm bill that truly supports our existing farmers. If the policy choice is to stem the restructuring process, the Government must enact stricter regulatory and more generous price support legislation than presently exists. If an effective regulatory and price support program is the policy choice, then the farm population's problems will be solved, at least the romance of family farm life will continue, for better or for worse awhile, free of a spectre in the form of a bankruptcy judge.

If the policy choice is to accept the current restructuring process, then the existing ineffective support system will be maintained, or the artificial props, the crutches that have been supplied for the past half century removed. This would put a risk over the long term perhaps 700,000 medium sized farmers. By medium sized, I mean farms of 400 to 800 acres generating $50,000 to $200,000 in revenues annually.

The risk of denying effective governmental assistance is not the same for all farmers. Farmers with limited debt who are good managers will undoubtedly survive but will face a further decline in income. For these farmers, a free market system will likely mean a lower standard of living.

Another group of farmers at greater risk in a market oriented system are those with debt to asset ratios of 40-50%. If these farmers are to remain in business, they will likely need some nonfarm income. They must also sharpen management skills, diversify on a modest scale and perhaps look to a labor intensive "natural family farm". These farmers might also voluntarily choose to leave farm life. A future which holds long hours with unpredictable returns may no longer be what they relish despite some visceral urge to till soil of their "own".

A third group of farmers are over-leveraged with debt to asset ratios exceeding 60%. There is no real solution for this highly leveraged group in today's economy or in a future free market agricultural economy. These farmers are in immediate danger of bankruptcy if they're not already in bankruptcy. In Iowa, farmers who are 60% or more leveraged may number 21% of our 115,000 farms. Under these assumptions, 79% of our Iowa farmers are less than 60% leveraged and should have a chance to remain in farming.

Of the farm cases filed this year in the Southern District of Iowa, approximately 89% have been liquidation cases. The remaining were filed as Chapter 11 or Chapter 13 reorganization cases. The relatively low percentage of reorganization cases filed this year is a departure from previous years. In 1983 and 1984, approximately one-fourth of our farm cases were filed as Chapter 11 reorganization cases.

This apparent trend away from farm Chapter 11 cases supports a view that I have held and urged the last two years. Chapter 11 was designed for the mercantile debtor not the farm debtor and that Chapter 11 is generally unworkable in the farm setting. Of the Chapter 11 farm cases that have been filed in the Southern District over the past three years, only 13% have reached confirmation. The very fact that Congress is now studying the legislation proposed here is a further indication that the existing reorganization provisions of Chapters 11 and 13 do not serve financially distressed farmers.

Chapter 11 is designed to give breathing room to the mercantile debtor that is beset by a specific event or a series of generally nonrecurring events. In return for this breathing room, Chapter 11 of the Code requires the debtor to provide some protection to its creditors during the reorganization period.

Unfortunately, the financial stress troubling farmers today is not tied to a specific event or a series of generally nonrecurring events. As noted earlier, many factors underlying the rash of farm bankruptcies include relatively high interest rates, insufficient and unstable demand for farm commodities, falling land values and vacillating governmental policies. In the absence of an upsurge in the foreign demand for our commodities or of a revolutionary farm bill, farmers will continue to be burdened by these macroeconomic forces for the foreseeable future. Thus, the temporary breathing space offered by Chapter 11 is to no avail in today's farm economy unless the farm business is well managed, inspires creditor cooperation, and has a core of productive assets.

Furthermore, unlike the typical mercantile debtor, the farm debtor's cash flow is of a highly seasonal nature. Although the mercantile debtor may use some of its predictable nonseasonal cash flow to provide some protection to its creditors during the reorganization, the typical farm debtor lacks not only a nonseasonal cash flow but also the ability to accurately forecast seasonal cash flow. Because the typical farm debtor cannot offer its creditors adequate protection during the course of a reorganization proceeding, Chapter 11 of the Bankruptcy Code and the case law interpreting it require that the creditor be permitted to foreclose.

The first move of the Bank, PCA, FmHA or FLB after a Chapter 11 petition is filed is to move the court to lift the protective automatic injunction which bars any action against debtors or their property. Again, the Code requires the Bankruptcy Court to remove this protection against foreclosure unless the Debtors can "adequately protect" their creditors. Such adequate protection requires that a farm or provide the creditor with such additional collateral or cash payments that the creditor will receive the benefit of its bargain and be insured that its collateral interest will not diminish. In short, a farmer is forced to compensate creditors for the delay in the enforcement of their rights caused by the Chapter 11 created "breathing space". In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984). The Eighth Circuit has adopted this burdensome concept in In re Martin, 761 F.2d 472 (8th Cir. 1985). The Martin decision holds that: "a debtor, in structuring a proposal of adequate protection for a secured creditor, should as nearly as possible under the circumstances of the case provide the creditor with the value of this bargained for rights."

Under the Martin holding, a bankruptcy court must (1) establish the value of the secured creditor's interest; (2) identify the risks to the secured creditor's value resulting from the debtor's request for use of cash collateral; and (3) determine whether the debtor's adequate protection proposal protects value as nearly as possible against risks to that value consistent with the concept of indubitable equivalence. In re Martin at 476.

Unfortunately, the vast majority of farm debtors are unable to provide creditors with adequate protection under the Martin analysis. Judge Fagg speaking for the Martin court states that "the concerns we express are not insurmountable" to which I as a work-a-day bankruptcy judge would offer---neither is Mount Everest. The problem again is that farmers simply do not have a predictable cash flow with which they can use to protect their creditors during the course of the bankruptcy proceeding. Furthermore, given the precipitous fall in farm asset values, farmers do not have additional collateral to offer creditors as protection. More often than not a farm reorganization case is throttled in its infancy by a motion for relief from the stay. Because farmers cannot offer adequate protection as is required by the Code and the case law, the stay must be lifted and the farmer's assets subjected to foreclosure and replevin. It goes without saying that once a farmer's assets are chipped away by these foreclosure and replevin actions, the ability to reorganize completely disappears.

Although the "adequate protection" requirement of the Bankruptcy Code is most troublesome to farm cases, other sections of the Code present difficult if not insurmountable hurdles for reorganizing farmers.

The 1984 Amendments to the Bankruptcy Code create one of these problems. Section 363(a) now encompasses "offspring." This amendment substantially altered the character of cash collateral by extending the definition of cash collateral to include "proceeds, products, offspring, rents or profits of property subject to a security interest as provided in § 552(b)...whether existing before or after the commencement of a case." Previously, a farm debtor in the ordinary course of business could sell post-petition offspring encumbered by a security interest. § 552(b). The new amendment precludes a farm-debtor from selling § 552(b) after acquired offspring without first obtaining the consent of the secured party or court approval, since the offspring now constitute cash collateral. The end result is that the Chapter 11 farm debtor is almost always plastered with liens and has nothing left to operate on or with.

Rehabilitation prospects are typically dependent upon a reamortization of debt obligations. Even though a reamortization may be approved over a secured creditor's objection under 11 U.S.C. § 1129(b), if payment is to be deferred to a secured creditor, both the length of the deferral and the interest rate to be paid over the deferral period must be reasonable, and the deferred creditor must be adequately protected. When creditors will not consent to a reamortization of debt the ability to confirm a deferred payment plan, and achieve a feasible reorganization, is limited. In the current economy the erosion of the value of collateral has left formerly secured creditors unsecured as to a large portion of their debt. So much so that in most cases the unsecured deficiencies of one, two, or three obdurate lenders dominate the unsecured creditor class whose consenting vote is essential to the confirmation of a plan of reorganization.

The alternative use of the cram-down provision of Section 1129(b) is of no value in the farm Chapter 11. Unless a plan of reorganization is either accepted by each unsecured class of creditors or each unsecured creditor receives property equal to the allowed amount of its claim, a debtor may not retain any property interest, including a right to possession, other than exempt property. 11 U.S.C. § 1129(b)(2)(B); See In re Knutson, 40 B.R. 142 (Bkrtcy. W.D.Wis. 1984); In re Genesee Cement, 31 B.R. 442 (Bkrtcy. E.D.Mich. 1983); In re Tomlin, 22 B.R. 876 (Bkrtcy. M.D.Ala. 1982).

It must be kept in mind that the essence of Chapter 11 is that of a consensual rehabilitation. The filing of a Chapter 11 does not force creditors to cooperate. Too many distressed businesses wait too long before filing a Chapter 11 case. Also, the farmer's congenital optimism generally results in a delayed filing. It is often filed after creditors have initiated proceeding to collect debts or recover collateral. These "eve of foreclosure" filings obviate or hinder the operation of a farm from the outset. Ordinarily there will be no lien free cash when it is most needed, and under the law, least accessible. More crucially, the eve of foreclosure filing indicates that the vital element of creditor cooperation in the Chapter 11 case will be missing. Not only that, the late filing raises the spectre of a bad faith filing. I refer you to In re Albany Partners, 749 F.2d 690 (11th Cir. 1984).

All of this is to say that the present Bankruptcy Code impedes rather than facilitates the reorganization of a farming operation. The two principal drawbacks being the requirements for adequate protection of secured creditors and the strict priority rule to achieve a cram down.

The legislation proposed here will not "solve the family farm crises in this country". The quote is from Congressman Synar, an author of similar legislation in the

House [131 Cong. Rec. H85 (daily ed. June 24, 1985) (statement of Rep. Synar)]. His hope is that it will "slow down the ongoing deterioration of rural America long enough for Congress to pass a farm bill...and take other steps necessary to revitalize our farm economy." Id.

If all this is true the proposed legislation is misconceived and misdirected.

CHAPTER 13 CHANGES

(S. 1342 & S. 1516)

Much has been made of the differences between Chapter 11 and Chapter 13. The point is made that Chapter 11 is a long and complex process, and that Chapter 13 is easier, quicker and less expensive. On its face that statement is correct and as presently administered Chapter 13 is less cumbersome. The proposed changes in Chapter 13 are designed to provide relief for the medium sized farm. There are now two distinct reorganization chapters for individuals. Chapter 11 for businesses, and Chapter 13 for wage earners with consumer debt, and small mom and pop businesses. The proposed amendments blur this distinction. Professor Frank R. Kennedy testifying before a House Committee has stated:

> Chapter 13 is less expensive, permits more expeditious adjustment in the form of a confirmed plan, does not permit displacement of the debtor in operation and possession of the property of the estate, obviates the need for and the expense of a creditor's committee, eliminates the necessity for preparation of and hearing on a disclosure statement and the solicitation and procuring of acceptances of a proposed plan, relieves the debtor from the pressure of co-debtors sued by creditors who are or will be provided for in the plan, relieves the debtor from the necessity of dealing with the complexities engendered by $ 1111(b) (affording recourse and nonrecourse lenders the option to retain liens for the face amount of their obligations), and protects the debtor from the risk of the cram-down of a liquidation plan formulated by a creditor.

It is my considered opinion that in the agricultural context Chapter 13 is not more expeditious. Mother nature governs the time table for a farming reorganization. It takes a crop year at least to see how a farmer performs and whether a next reasonably good harvest will give him a foundation on which to go forward with a repayment plan.

The risk of a farm debtor being displaced by a trustee is nill. No one wants a trustee including major creditors. There also are no trustees available for the compensation allowable under Chapter 11. I cannot recall a trustee ever having been appointed in a farm reorganization case.

While there are creditors' committees in Chapter 11 cases, they never, and I mean never, function in the farm reorganization. I can remember only one instance, and that was a unique situation involving the joint ownership of a very famous bull. Creditors' committees in practice cost nothing in the reorganization of a Chapter 11 farm case.

I have never seen a farm case fail because of the need for a disclosure statement. A disclosure statement is one of the most essential ingredients in any Chapter 11 case, and should be in any reorganization where dollar amounts in the millions will be dealt with over a period of time. Many family farms that will be administered under these Chapter 13 amendments will make millions of dollars of debt and operating payments over the course of a 10 year plan. Adequate information is not only important for the creditors in cases of this size, but also for the debtor. It will probably be the first and most complete analysis of the debtor's true financial condition and prospects that has ever been made. It makes the debtor face the fact that what he wants to call a reorganization is really a pipe dream. Because of the small number of creditors in most farm reorganizations, preparation of the disclosure statement is not a financial burden.

As for Section 1111(b) of the Code and "complexities engendered by it" I would say I have again only seen it invoked gingerly in one action, so tenatively in fact, that the creditor quickly backed off. Not only that, if properly used, it is a simple device that would prevent abuses by farms in reorganizations if land values start to rise.

The co-debtor protection is meaningless because it applies only to "consumer" debt.

Chapter 11 can be easily amended to protect the farmer against a creditor liquidation plan.

This leaves only two significant differences between Chapter 11 and Chapter 13 and those are the cramdown provisions and the availability of a hardship discharge.

Under Chapter 13, a plan may be confirmed over the objection of an unsecured creditor if the plan provides for either (1) full payment, or (2) that all of the debtor's projected disposable income to be received in the first three years be applied to plan payments. Disposable income is liberally defined to be income remaining after payment of both living and business expenses. Given this liberal confirmation rule, the major problem of the recalcitrant unsecured creditor in the farm Chapter 11 is avoided.

Secondly, a bankruptcy discharge may be received under Chapter 13 even if the plan is not carried out. Contrary to Chapter 11, Chapter 13 provides for a discharge despite the failure of a plan if: (1) the failure to carry out the plan was due to circumstances for which the debtor was not justly accountable; (2) modification of the plan is not practicable; and (3) unsecured creditors have received at least what they would under Chapter 7. This provision would seemingly provide for a farmer's discharge where his plan's failure resulted from weather conditions, grain embargoes, or other factors beyond his control. These critical needs can be met by amending Chapter 11, and obviate corrupting Chapter 13.

Senate Bills 1342 and 1516 raise the debt limits ($100,000 unsecured debt, $350,000 secured debt) which now restrict eligibility of most farmers for relief under Chapter 13. This more than doubles the present limits (S. 1516, $1,500,000 secured and unsecured) (S. 1342, $1,000,000 secured and unsecured debt). Despite these new debt ceilings, many deserving family farms in the mid-West will be left in Chapter 11 with its present drawbacks while their neighbors down the road will have the liberalized advantages of a new Chapter 13.

It must be kept in mind that this invitation to Chapter 13 does not relieve the debtor for the obligation to give secured creditors adequate protection against any diminution in the value of collateral during the Chapter 13 case. This is the primary obstacle to achieving confirmation for most farmers large or small. These proposed amendments ignore this fact. The point is that as long as their major creditors are not adequately protected, as is more often than not the situation, a new Chapter 13 will be of no more assistance than the old Chapter 11.

Another problem concerning the magnitude of the proposed lifting of the Chapter 13 debt ceiling raises serious social welfare questions in my mind. The debt forgiveness imposed by existing Chapter 13 is somewhat limited given the current 100,000-350,000 debt cap. Thus, although an objecting unsecured creditor can presently be forced to forgive debt under Chapter 13, the size of the loss is, in most cases, manageable. The policy choice apparently is that we'll force a limited number of creditors to take a loss in return for permitting a debtor to continue as a contributing element in society. Because the loss in most instances is relatively small, society has eveidently deemed it fair to force a small segment of our population rather than society as a whole to accept the loss.

Under the proposed amendments, however, the debt forgiveness imposed by Chapter 13 may very substantial. We will be seeing composition repayment plans of 5 and 10%. Under Senate Bills 1342 and 1516, farm creditors who have become undersecured through the fall of farm asset values, could be forced to forgive large amounts of debt.

The question that arises is whether we should ask this small segment of our society to bear the cost of the apparent societal desire to give family farmers a break. In short, if the choice is made to attempt to temporarily ease the pain of agriculture's restructuring process, should we ask a small segment of our society--the farm creditors--to pay for this choice or should the cost be spread over all of society.

I wonder if we are all in agreement that the farm debt problem should be thrust on farm credit bond holders, county seat Banks and small town trade creditors in lieu of addressing the problem with tax revenues. I can think of nothing that would more quickly put a chill on farm credit, not only now, but in a hopefully brighter future, than to impose all debt forgiveness on this isolated class of creditors. Remember, these amendments, while designed to treat a special group in a unique situation, have no time limits in them. The Bankruptcy Act of 1898 lasted until 1979.

The proposed amendment to Section 1322(b)(2) permits modification of debt secured by the principal residence of the family farmer debtor on or near the farm itself. Why this home is any more sacred than that of a wage earner escapes me. Particularly, when there are more homes becoming available in farm neighborhoods at far less rent than it takes to maintain them. Owners will take anything to keep warm bodies in them just to retain insurance in force. I see no reason for this exception.

The family farmer and the closely held farm corporation under the proposed amendments are given all the broad advantages of a Chapter 13 discharge of debt. This could invite abuse of the legislative purpose, provisions, and spirit of Chapter 13. The appellate courts have approved very deep composition plans, that is small percentage plans. After completion of the plan, all unsecured debts are discharged except debts for alimony and support under Section 523(a)(5) of the Code. Which is to say that a farmer and his corporation could be discharged from debts arising from the willful and malicious injury to property (conversion of a lender's collateral); debts arising from false pretences, fraud, or materially false financial statements; drunken driving; student loans; debts owed to undisclosed creditors; debts arising from a breach of a fiduciary duty, embezzlement, or larceny; and fines imposed by a governmental unit.

Experience has taught me no economic segment of our society is free from cheaters. In the farm sector, lenders are particularly vulnerable to the dishonest borrower. Hard to trace livestock, grain, cash proceeds, and machinery either disappear or cannot be accounted for. Financial statements required by all lenders are relied upon to determine whether larger loans should be made. Many farmers do not take such statements as seriously as they should. Too often the statements are treated as a mere formality. Some deliberately fudge, others are just careless about how they count and value assets or list liabilities. Farm financial statements frequently contain significant (material) omissions and asset overstatements. Omissions of substantial liabilities or overstated assets on a financial statement where the maker knows or should know that the statement must reflect the amount of total liabilities, assets and net worth, makes the statement materially false and nondischargeable. *Trimble v. Chariton & Lucas County National Bank*, 55 F.2d 165 (8th Cir. 1932); *In re McCallister*, 3 C.B.C. 693 (Bkrtcy. S.D.Iowa 1975). In short, farm lenders can be and are taken for large sums of money; far larger that the amount of consumer debt or small business losses that Congress originally intended creditors should absorb. Chapter 13 could become a sanctuary for the harder to detect, not so honest farmer. The fact that such persons might escape the civil law remedies of lenders will also discourage the extension of credit.

Furthermore, the use of trustees as proposed by these amendments will be difficult to implement. The Southern District of Iowa has two trustees that must handle Chapter 13 debtor cases in court points 300 miles apart. These Chapter 13 debtors are nearly all wage earners who simply send a periodic check, or have an employer send a check taken out of their pay. It is a simple process, easily managed and the average total unsecured debt is about $12,000.00. The trustee receives 10% of the amount of money handled for compensation and expenses.

The farm 13 would create a whole new way of doing business for the Chapter 13 trustee. Under Section 1302(c) the trustee must investigate the financial transactions of a business debtor, his conduct of business, his assets and liabilities, the operation of the business and then report on the investigations.

This would be infeasible for the present standing trustees. They would not have the time to cover the distances involved, let alone investigate. They do not have the farm business knowledge required, and the pay would be too low for the effort required. The maximum annual compensation for the Chapter 13 trustee in a non-pilot state is the same as a GS-16 of the general schedules of U. S. employees. The amount of premiums required to bond the trustee would be prohibitive. I do not believe I could sell any person, otherwise qualified to even consider the job.

Imposing a duty on the court to determine when payments must start under a Chapter 13 plan is unrealistic and in the extreme. It assumes that a farm reorganization plan will be filed at the time the bankrupt's petition is filed. It will not, in most cases. We don't even get schedules and statement of affairs filed at the time a farm petition is filed, much less an extensive reorganization plan that might cover operations for the next ten years. The requirement to hold a hearing for purposes of determining when the payments will start after a plan is filed would require prescience beyond that of any judge I know. The proposal also bespeaks a complete lack of understanding as to the time bankruptcy judges have to devote to hearings arising from their present case loads. In the week of the 29th of September this year, I held 234 hearings dealing with millions of dollars, in two cities 200 miles apart.

Affairs of farmers coming into bankruptcy for reorganization are too complex, cobbled, and controverted to be treated at such an early hearing.

The proposed Chapter 13 amendments have no value, they are unworkable, will not serve the purpose they are intended to serve. They will prejudice creditors, place a burden on the court system it cannot handle as now constituted, and by singling out the "family farmer" defeat the original purpose of Chapter 13, as amended in 1978, to effect changes in "consumer bankruptcy" and their relation to "wage earner plans." They also corrupt the concept of a "uniform" Bankruptcy Code for the United States. My experienced colleague in Minnesota, Chief Bankruptcy Judge Connelly, concurs with these conclusions.

PROPOSED AMENDMENTS TO CHAPTER 11

(S. 705)

If Congress is bent on aiding the financially distressed family by way of the Bankruptcy Code, that is, provide some respite until it solves the farm sector economic problem, or until time and events either solve them or restructure the farm sector, it should look to Chapter 11 exclusively. Senate 705 is the correct approach but it does not cover a wide enough range of factual and legal considerations.

If the definition of an individual farmer conforms to 11 U.S.C. § 101(17), as being one receiving more than 80% of their gross income in the previous taxable year from a farming operation, it leaves out many of the most deserving farmers. This limitation on nonfarm income would exclude the family farmer or farmer's spouse who has been forced to take a job in town or in some other fashion supplement their farm income.

The broad right to be heard granted to government officials invites bureaucratic delay, complication and distraction. If there is a good reason for government agencies to be heard, the courts traditionally accommodate them in bankruptcy hearings.

An "optional" creditors' committee is superfluous. I know of no active statutorily authorized creditors' committee in a farm bankruptcy case in the Southern District of Iowa. The expense of committees, attorneys and accountants is a burden that most farm estates cannot bear. Such committees are not needed in farm cases and in actual practice take no part and offer no assistance.

Section 1181 of Senate 705 alleviates the need to file a disclosure statement. I noted earlier that the essence of Chapter 11 is the consensual reorganization. The philosophy of the Code encourages parties to negotiate a workout within its framework. Without a full disclosure this is difficult at best.

Section 1187 of the Bill allows only the farmer to file a plan, and removes the existing 120 day filing deadline. The only deadline for filing a plan under this amendment would be a deadline that a court might impose. The current 120 day deadline may seem oppressive in some cases. However, my experience has been that the parties will generally have a good idea well before 120 days whether a given Chapter 11 has a chance of succeeding whatever the plan might be. If it is apparent that a farmer has a chance for a successful reorganization, the present 120 day deadline may be, and uniformly is, extended. An unlimited plan filing period will only encourage harmful procrastination.

There is a provision in Senate 705 that addresses a farmer's emergency need for credit. Under Section 1186, a court may authorize a farmer to incur secured debt without any notice having been given to creditors and without hearing. Debt may be incurred in this manner if the farmer's livestock are in danger by reason of a farmer's lack of funds. It may be helpful to have such a provision added to the Code, but I would sincerely hope that no one believes the bankruptcy courts have been so bound by existing notice and hearing rules that they have watched livestock suffer or grain rot. If livestock need feed, the courts see to it directly, usually by telephone. The need to notice creditors is unnecessary and an imposition on all concerned. Additional paper in a file is seldom the solution of any problem. Section 1186 will only codify existing practice and not open doors to confirmation of a reorganization plan for farm debtors.

Section 1189 alters the existing confirmation standard for Chapter 11 plans. The significant changes are: (1) the elimination of the protection for dissenting members of a class, and (2) the elimination of the necessity to pay administrative claims in full upon confirmation. The existing confirmation standard contains a section which protects dissenting members of an accepting class. Under 705, however, accepting class members may bind a dissenting class member to receive less than the dissenting member would receive under Chapter 7. This appears to be a drastic and unwarranted departure from the "fair and equitable" standard of the present Code and is probably unconstitutional.

The withdrawal of the requirement that administrative expenses be paid in full on confirmation will provide some benefit to cash strained farm debtors. It is doubtful that this provision will enhance the viability of a farm Chapter 11. Furthermore, the withdrawal of this provision may seriously impair the farmer's ability to obtain necessary supplies and services throughout the administration of the case. Presently, many suppliers are willing to extend unsecured credit to the Chapter 11 farmer prior to confirmation only because they know that they will receive an administrative priority claim in cash, or by agreement at least sometime prior to any distribution to any unsecured creditors.

Finally, the most troublesome aspect of Senate 705 is its failure to address the two provisions that curse 99% of all farm Chapter 11 cases, the adequate protection requirement and the strict priority rule. The Bill retains in its entirety the existing adequate protection and strict priority confirmation sections. I suggest that Senate 705 be reworked, and incorporate provisions softening the present rules against the use of property in early stages of the Chapter 11 case, and liberalizing the restrictions on confirmation where a debtor seeks to retain some interest in the operation. I do not believe a possessory right, the right to manage the farm operation, or the right to some income during a reasonable period of recovery is asking too much of creditors and should not violate the Constitution.

Thank you again.

Richard Stageman

(Addendum)

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1985

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT thru 29	NOV	DEC
CHAPTER 7)	24	28	42	85	46	37	23	21	18	12		
CHAPTER 11)	1	4	6	10	5	4	6	6	2	2		
CHAPTER 13)	1	0	0	1	0	0	0	2	1	0		
TOTAL	26	32	48	96	51	41	29	29	21	14		
YTD	26	58	106	202	253	294	323	352	373	387		

(Addendum)

SOUTHERN DISTRICT OF IOWA

BANKRUPTCY CASES FILED

1985

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT thru 29	NOV	DEC
FILINGS..............	175	216	247	278	251	253	277	217	233	232		
JOINT.................	97	123	143	172	135	140	151	116	131	130		
TOTAL PER MONTH.................	272	339	390	450	386	393	428	333	364	362		
YTD FILED.............	175	391	638	916	1167	1420	1697	1914	2147	2379		
YTD-INC. JOINT........	272	611	1001	1451	1837	2230	2658	2991	3355	3717		

TOTAL CASES FILED

		(Inc. Joint Filings)
1979.........	1567......	1713
1980.........	2169......	3298
1981.........	2396......	3734
1982.........	1908......	2948
1983.........	1825......	2836
1984.........	2024......	3113
1985 thru 10/29..	2379..	3717

SOUTHERN DISTRICT OF IOWA

CH. 11 BANKRUPTCY CASES FILED

1985

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT thru 29	NOV	DEC
FILINGS)	7	16	12	18	9	17	9	15	9	7		
CONVERSIOUS)	4	5	6	6	7	4	6	6	0	8		
TERMINIATED)	6	5	7	7	8	8	9	8	13	13		
TOTAL PENDING)	213	219	218	224*	217	224	220	221	217	219		

* New count

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1984

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC	TOTALS
CHAPTER 7)	14	20	30	32	22	15	11	6	13	7	14	8	(192)
CHAPTER 11)	3	3	13	8	10	9		2	3	6	5	2	(64)
CHAPTER 13)											2		(2)
TOTAL	17	23	43	40	32	24	11	8	16	13	21	10	
YTD	17	40	83	123	155	179	190	198	214	227	248	258	(258)

2024 CASES FILED IN 1984.
258 OR 12.75% WERE FARM CASES.

SOUTHERN DISTRICT OF IOWA
FARM BANKRUPTCY CASES FILED
1983

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC	TOTALS
CHAPTER 7)	8	11	24	9	15	10	6	8	5	12	10	14	(132)
CHAPTER 11)	3	3	7	4		2	1	4	5	1	6	3	(39)
CHAPTER 13)					1		1				2		(4)
TOTAL	11	14	31	13	16	12	8	12	10	13	18	17	
YTD	11	25	56	69	85	97	105	117	127	140	158	175	(175)

1825 CASES FILED IN 1983.
175 OR 9.59% WERE FARM CASES.

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1982

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
CHAPTER 7)	7	7	12	5	13	9	3	5	7	5	3	9
CHAPTER 11)		1	5	3	4			1	2	2	4	6
CHAPTER 13)	1				1	1			1			
TOTAL	8	8	17	8	18	10	3	6	10	7	7	15
YTD	8	16	33	41	59	69	72	78	88	95	102	117

1908 CASES FILED IN 1982.
117 WERE FARM CASES.

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1981

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
CHAPTER 7)	3	1	1	1	2	4		1		1	4	4
CHAPTER 11)										1	1	4
CHAPTER 13)							1					
TOTAL	3	1	1	1	2	4	1	1	0	2	5	8
YTD	3	4	5	6	8	12	13	14	14	16	21	29

2396 CASES FILED IN 1981.
29 WERE FARM CASES.

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1980

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC
CHAPTER 7)				1	1		1					
CHAPTER 11)						1	1				1	1
CHAPTER 13)												
TOTAL				1	1	1	2				1	1
YTD				1	2	3	5				6	7

2169 CASES FILED IN 1980.
7 WERE FARM CASES.

SOUTHERN DISTRICT OF IOWA

FARM BANKRUPTCY CASES FILED

1980) 2169 CASES FILED........7 OF THESE WERE FARM CASES

1981) 2396 CASES FILED.......29 OF THESE WERE FARM CASES

1982) 1908 CASES FILED......117 OF THESE WERE FARM CASES

1983) 1825 CASES FILED......175 OF THESE WERE FARM CASES

1984) 2024 CASES FILED......258 OF THESE WERE FARM CASES

1985) thru 10/29

2379 CASES FILED......387 OF THESE WERE FARM CASES

Senator GRASSLEY. Would you make that same statement, not only in my State but let us say throughout the country, if we had the right number of judges, whatever that right number is? Would you still be saying what you are saying about chapter 13 versus chapter 11?

Judge STAGEMAN. Well, I agree we need more judges. But I view it this way. If this thing would be cured by some act of God or whatever and we get back to a more normal period, one judge could handle it. You get a judge in office, you are going to have him forever.

Now, our district is really tougher than the northern district. We have always had a 2, 3, 400 cases more. Our travel is the same. Our district is up to date. On top of that, for 10 years I have held the cases in Nebraska. For the last 6 months I have been acting in the northern district. It can be done, but you shoot from the hip a lot, and sometimes you wonder whether you are a judge or whether you are Roy Bean.

In fact, some of the lawyers in Dubuque call me the law west of the Mississippi. But that is the only way you can get the job done.

Senator GRASSLEY. Chairman East.

Senator EAST. Judge, I would like to ask you one question relating to this amendment of the adequate protection and cram-down rules. You had mentioned this.

In what fashion, how would you amend those?

Judge STAGEMAN. You run into a delicate constitutional question here of taking. I am not sure I have an answer to that. I honestly do not. I feel that they could liberalize the time within which a debtor would have his immediate cash proceeds available.

For example, in 1984, they amended the Bankruptcy Act to include in the definition of cash collateral offspring. Between 1978 and 1984, under section 552 of the code, a farmer could use offspring born after he filed his case. He could use that cash to keep himself going. Now, that that is cash collateral, he has to have the consent of the secured party or the consent of the court. The secured party is not going to rarely consent unless they are starving.

Also there is, I think, an area here where you could liberalize indubitable equivalent. I once said the indubitable equivalent of cash is cash, and that was somewhat followed by the eighth circuit recently in the *Martin* case when Judge Fagg was speaking for the eighth circuit and talked about what you had to prove in order to get the use of cash collateral, and specified what the court had to consider.

First of all, we would not have time to consider it. But he said these problems are not insurmountable to which I would reply, as a work a day bankruptcy judge, neither is Mount Everest. I think you would have to—let me put it this way, you asked for a definition of indubitable equivalent. That was Judge Learned Hand's high flowen phrase many years ago. It is really is a pretentious term for doubtless equivalent. It is the doubtless equivalent of whatever you are dealing with that belongs to a creditor.

If you could get by constitutionally liberalizing that, you would give real breathing space and prevent the PCA, the Federal Land Bank, the FmHA, the banker from coming in within 20 minutes after the case is filed saying give me adequate protection. I want the indubitable equivalent of the cash collateral, or I want the automatic stay raised because you cannot protect me against any diminution of assets. Land prices are falling, machinery prices are falling, they have no equity. The court has no choice. We are a court, we are not babysitters for farmers. We have to look at the creditors' side and the farmers' side. But under law as she is written, there is no way to protect them.

Senator **East**. Thank you.

Senator **Grassley**. You stated the difference between chapter 7, and chapter 11 and how that relates to the backlog of cases.

You stated that most cases filed in your district are liquidation cases under chapter 7. In the northern district of Iowa by contrast there seem to be a fair percentage of farm chapter 11's filed. In fact, that is part of the reason for the big backlog of cases there. We all agree to that. I would like to have you focus upon this difference between the districts.

Judge **Stageman**. Well, I suppose, to be quite honest with you, I have discouraged 11's because they just do not work. 1983, I confirmed five out of I do not know how many. I confirmed five in 1984. I do not think—there is probably two of those still operating under a plan, I know one hog confinement operation is hanging by its fingernails.

Chapter 11 is not designed for this situation. And I have told the lawyers, and the lawyers agree with me. One, chapter 11 is an absolute last resort. Any type of workout is better than a chapter 11. But their clients say I have got to have a little more time, and they wait until the eve of foreclosure, and they come running in with the chapter 11. It raises the specter immediately of a bad faith filing. Are you in here to reorganize or are you in here to get another crop year? They get another crop year. It is a hopeless situation. They are a 100 to 120 percent leveraged. They would have to have a 10 percent return on capital to carry their debt load no matter how they stretched it out, and they cannot make 2 percent or even break even on their assets, and most of them are losing right now.

Senator **Grassley**. I am not going to say anything to disagree with you. Maybe I can shed a different perspective on it from the viewpoint of agriculture as opposed to other businesses. And it seems that in agriculture, hope springs eternal, there is always next year, it is going to be a different situation, we are going to have a better year, we are going to work our way out of it.

Judge **Stageman**. I know all about that.

Senator **Grassley**. Well, couple that with the nostalgia for the family farm, and a common understanding of the contribution farmers make to the production of food in this country, at a cheap and reasonable price for the consumer along with high quality product and, of course, all those things are put right on your shoulders then as a bankruptcy judge, aren't they?

Judge **Stageman**. That is true. And I am an advocate of the family farm. I was a hired man in Nebraska at age 14. I had a personal acquaintanceship with farm failure, farmland values. I am a family farm advocate but I am a judge also. And what we are doing here really to a large degree, if we really want to face reality is trying to preserve the myth of the American Gothic.

Senator GRASSLEY. The only thing I would say in rebuttal is that its true that if an individual farmer makes a bad judgment, there is nothing in our society that guarantees people the right to farm. There is nothing in our society that guarantees farmers a profit any more than any other business.

But as I see the last 5 years, there have been so many decisions beyond the control of the individual farmer. I guess that is why I am sympathetic to changing bankruptcy laws to give farmers one more chance because an irresponsible Congress has kept budget deficits high, interest rates high, the value of the dollar high, or because a Paul Volcker decided to deflate in October 1979. There is no way agriculture could predict these events. We have also had embargoes by both Republicans and Democrats that have been detrimental to agriculture', we have had acts of nature that I suppose we generally ought to praise, but they have been to the economic detriment of Midwestern farmers. When we have had a situation in 1981, 1982, 1984, and 1985 worldwide, we have had back to back wonderful weather that has produced a tremendous overhang on the market. And if there is hope for the family farmer, if there is a justification for some special consideration in bankruptcy, if there is a justification for one last ray of hope, then, you know, I think it comes because of what we do right now. I do not know whether you can find 4 or 5 years in modern agriculture where, because of political decisions and good weather, we found so much disaster in any one segment of the economy. And that is kind of why, I hold these hearings, and it is why any last look at what we can do to give farmers one more chance is probably received relatively favorably here on the Hill, even though, there are not a lot of people on the Hill that represent agricultural interests, particularly in the other body, where only about 60 or 70 districts have a great deal of agriculture in them.

Judge Stageman. Well, could I just say——

Senator GRASSLEY. Yes. I have some more questions too, but go ahead.

Judge STAGEMAN. Well, apropos to what you just said.

I agree with everything you said. I do not disagree with anything you say. What I am questioning here is whether the immediate problem of the family farmer falling between the cracks, as we say, should be placed in the context of a bankruptcy court and a bankruptcy law when the underlying forces that have caused it are not the sort of forces that ordinarily cause the financial problems that can be solved in the bankruptcy court.

This problem is much bigger than the bankruptcy courts can handle or the bankruptcy courts have a solution for.

Senator GRASSLEY. Let me agree with you. Let me agree with you and say that, you know, what we do on interest rates and what we do on the value of a dollar and what we do on the farm bill and what we do on fighting for our fair share of international trade is obviously more important than this, but this is a part of it. It is a big puzzle we are dealing with and it takes a lot of pieces to put that puzzle together. And admittedly this may be a small part of that puzzle, but it is a part of it. So I do not disagree with you. In fact, I would even take your statement as an admonition to us to get on and to get the job done here in these other areas as well.

You heard me ask the Congressmen a question about the definition of a family farmer, for bankruptcy purposes—I guess I would ask the same question the same of you, but with the addition of whether or not the family farm as a business entity deserves any special definition.

Judge **Stageman**. I am often quizzed when I use that term. They say what are you talking about, a family farmer? Do we not have family fisherfolk and do we not have, you know, family green grocers and things like that? Why is the family farm so special?

Well, I think it is because we all have an ancient or visceral urge to go out and grow something, and this appeals to all of humanity. And it has been humanity's principal occupation until more recently in this country, and it is in still many parts of the world.

I do not know whether you are talking about a husband and wife and some children. I think it is easier to define it as a way of life and surrounding a group of closely related people ordinarily related by marriage and blood.

But that does not work when you are trying to pass laws, and I think the definition they came up with in section 101, I think subsection 17 of the present code is not workable, because it refers to 80-percent income. That cuts out too many farmers who have had to go to town to help keep things going. That is not a good definition.

The one that says 80 percent of your debts is better. But whether 90 percent, 80 percent, 70 percent, who knows, just flip a coin. And I do not know what else you can do.

My big trouble is is determining whether a spouse is a farmer when the spouse is working in a bank. And I am very liberal about that. I have often said to a spouse have you ever helped pull a calf, have you ever taken lunch to the field, have you helped with the chores, did you ever get on the tractor for awhile? Sure. You are a farmer.

Senator **Grassley**. Well, I think obviously it is very difficult, but we do appreciate your statement that we ought to stick by the existing definition.

I have four questions I am going to submit in writing to you and ask you to respond in writing. I need to do that because of time.

Judge **Stageman**. Certainly.

[Information follows:]

United States Senate
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WASHINGTON, DC 20510

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November 19, 1985

The Honorable Richard Stageman
312 U.S. Courthouse
East First and Walnut Streets
Des Moines, Iowa 50309-2099

Dear Judge ~~Stageman~~ Richard:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 6, 1985 concerning farm bankruptices.

Your response by December 2, 1985, to the following questions would be appreciated:

1. In your testimony you suggested that the two most pressing problems facing farmers trying to reorganize are (1) freeing up use of cash collateral and (2) staving off attempts to lift the automatic stay. Can you suggest any amendments to the Code that would address these problems, but still be fair to creditors?

   For example, would it be wise for Congress to simply prohibit motions for relief of stay within the first 120 days after the order for relief in a farm Chapter 11? Does this suggestion raise any Constitutional problems with respect to a creditor's rights?

2. It's been suggested that the absolute priority rule presents problems for farmer-debtors. Do you agree? Would it be wise to amend the Code to make it clear that crop proceeds can be retained by the debtor in order to pay creditors, without violating section 1129 (b)(2)(B)(ii)? Would this be unfair to creditors?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck

CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF IOWA
312 U.S. COURT HOUSE
DES MOINES, IOWA 50309-2099

JUDGE RICHARD STAGEMAN
PRESIDING

AREA CODE 515
PHXXXXX
515/284-6229

December 10, 1985

The Honorable Charles E. Grassley
United States Senator
232 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Grassley:

Excuse my delay in answering your letter of November 19. The press of business has not abated. Through November, this year, we have had a record 2,660 cases filed in this district. In that regard, I wish to thank you for your efforts in getting another judge for this district. I do appreciate it.

As for the questions you asked in your November 19th letter, I would offer the following comments.

As you have indicated, I perceive the demand placed on debtors to provide their creditors with adequate protection as the largest hurdle for a farm reorganization case. Because the typical farm-debtor lacks sufficient cash or debt free assets to offer his creditors as protection, the Code demands that the farmer be barred from using cash collateral and that his creditors be permitted to pursue their state law collection remedies.

The 1978 Code's adequate protection requirement is based not only on constitutional grounds but also on policy grounds. See H.R. Rep. No. 595 at 339, 1978 U.S. CODE CONG. & AD. NEWS at 6295; *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1953). As stated in the House Report appurtenant to the 1978 Code, "Secured creditors should not be deprived of the benefit of their bargain." H.R. Rep. 595 at 339. The question, therefore, is whether the proposed 120 day moratorium on relief from the automatic stay motions would either violate the Takings Clause of the U.S. Constitution (See *Radford*), or drastically alter the policy notion that a secured creditor should have the benefit of its bargain.

The *Radford* decision may be read to prohibit Congress from enacting an absolute moratorium provision. In my view, such a reading would be overly restrictive. The statute before the *Radford* court (Section s of the Frazier-Lemke Act) provided for a five year moratorium on foreclosures with only minimal protective provisions for secured creditors. A limited 120 day moratorium with some provision for compensation for the secured creditors (i.e., rental payments with 11 U.S.C. § 503(b) priority) would, in my opinion, clear a challenge under the Takings Clause of the U.S. Constitution. *Cf. Wright v. Vinton Branch of the Mountain Trust Bank*, 300 U.S. 441 (1973). The *Wright* court was confronted with a revised version of the Frazier Lemke Act. In short, this revised version provided for a moratorium of up to three years; if a debtor failed to make required rental or principal payments, the secured creditor could move for a termination of the moratorium. The required payments were to be ordered either quarterly, semi-annually or annually. Thus, the earliest the moratorium could ever be terminated would be 90 days after adjudication. Again, it would appear that a 120 day moratorium with a compensation provision for secured creditors could withstand a constitutional attack.

I note, however, that a moratorium provision would not in any way assist a farmer in his efforts to use cash collateral. A moratorium would not alter the requirement that a farmer provide a secured creditor with compensation for the use of such collateral. Although a limited moratorium against foreclosure actions may permit a constitutional deprivation of a secured creditor's property interests, a provision permitting the free use of cash collateral would, in my opinion, unconstitutionally deprive a creditor of its property interests. Once cash collateral is used, the secured creditor's property interest is diminished. Such an alteration of property interests would be unconstitutional absent some requirement that the creditor be assured that the original cash collateral used would be adequately protected. In short, I do not feel that the Code can constitutionally be altered to facillitate a farmer's use of cash collateral.

On a more practical level, farms that have a viable chance of surviving typically either have the means to provide adequate protection or they have such cooperation from their creditors that strict adequate protection is not demanded. Certainly, the adequate protection requirement has caused many farm reorganizations to fail. Although it is often the adequate protection requirement that causes a farm bankruptcy reorganization to fail, it is the overwhelming debt load that leads the farm into bankruptcy and the subsequent failure. In short, the only change in the adequate protection standard that will save otherwise hopeless farm cases is a change that will effect a massive forgiveness of indebtedness.

This brings me to the absolute priority rule of Section 1129(b)(2)(b)(ii). It also is a major problem for farm-debtors. Under this section, a farmer who does not have the cooperation of his unsecured creditors must forfeit all property interests. Given the precipitous fall in farm asset values that has occurred over the last eighteen months, formerly secured creditors have often become undersecured to such an extent that they are able to control the unsecured class of creditors. Too often, this large unsecured creditor (who was formerly fully secured), is opposed to a voluntary forgiveness of indebtedness. As a result, the plan may not be confirmed if it permits the farmer to retain any property.

The problem with the proposal that permits a farmer to retain crop proceeds in the face of a Section 1129(b)(2)(B)(ii) challenge is that such a proposal invariably will seriously impair the interest of a secured creditor. Only in the rarest case will a farmer have a crop that is not tied up by a secured creditor who has financed the operation either pre or post petition. Such a proposal would either violate Section 1129(b)(2)(B)(i) or the Taking Clause of the U.S. Constitution or Section 361 of the Code. It may be that Congress could allow a right to possession of farmland even after title is lost, permit the farmer to take a living off of it for a long enough period to bring mortgage arrearages up to date, couple it with unsecured debt forgiveness that would withstand a constitutional challenge.

Again, thank you for your interest. If I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Richard Stageman

Richard Stageman
U. S. Bankruptcy Judge

Rick

Senator GRASSLEY. Thank you, Judge Stageman.

I would call our next witness, Mr. Ewen Wilson, who is the Deputy Assistant Secretary for Economics with the U.S. Department of Agriculture.

Mr. Wilson, thank you very much for coming and ask you to go with your summary of your statement, and to remind you that your entire statement will be printed in the record as submitted.

STATEMENT OF EWEN M. WILSON, DEPUTY ASSISTANT SECRETARY FOR ECONOMICS, U.S. DEPARTMENT OF AGRICULTURE

Mr. WILSON. Thank you, Mr. Chairman, members of the subcommittees. I am very pleased to have this opportunity to appear before you.

You very well know that the farm sector is in the midst of a very difficult financial and structural transition. And if you look at current forecasts, they suggest that there is little prospect for improvements in demand for farm products that are sufficient to justify the high prices paid for farm land in the late 1970's. As a result, those farmers who bought land through debt financing are now experiencing significant financial stress. Furthermore, farmers' financial problems have spread to the agribusiness sector and rural communities generally, both directly through farmers' reduced purchasing power and indirectly through the farm sector's adverse impacts on rural lenders.

The current financial conditions of farms, nonfarm rural businesses and rural lenders are all interrelated. USDA's January 1985 Farm Cost and Returns Survey indicated that 10 to 12 percent of the 2.2 million farmers in the Nation are in serious financial stress. Developments since that survey was conducted in January in the commodity and land markets suggest that the farm financial situation has perhaps worsened.

Financial problems in the farm sector stem from an inability to service the existing interest repayments and debt load of the sector from operator earnings. These problems have been exacerbated by a decline in asset values. Nearly $150 billion worth in owner's equity was lost through land value depreciation between 1981 and 1985. This reflects, of course, the nationwide decline in the value of farmland of about 19 percent, and in the Midwest it is much worse than that. If you look at recent surveys conducted by the Federal Reserve banks, they would indicate that land values have continued to decline particularly in the Midwest during 1985.

If there is one thing that you can point to as an origin for these problems, it is probably the boom years of the 1970's when U.S. agriculture saw tremendous rates of growth. Farm exports grew fivefold during the 1970's to a record $44 billion in fiscal year 1981. Farmers planted fence-row to fence-row, bankers enthusiastically financed that expansion. We saw an additional 55 million acres of U.S. croplands coming into production, average yields up by 30 percent, hundreds of millions of dollars spent on machinery and equipment. All appeared to herald a new era of financial prosperity for rural America.

Rising farm incomes helped pay for some of this investment, but the bulk of it was financed by borrowing. Farm debts rose from about $50 billion in 1970 to $130 billion in 1980, and in 1985 were about $212 billion.

Financial conditions in the seventies offer the powerful rationale for buying real assets such as farmland. Farmers and others eagerly sought farmland as a hedge against inflation and, for awhile, they were not disappointed. The average value of farmland increased by more than 13 percent annually during the 1970's, and although nominal interest rates were on the rise, real interest rates were low and even negative during that period. The combination of a strong export market and high inflation reinforced the demand for farmland.

But almost overnight, world recession slowed the growth in demand for farm products, halting the incredible gains in trade. Inflation was brought under control, but only with record high real interest rates. And that coupled with declines in producer returns led to a downward adjustment in land prices. Aggressive expansion in productive capacity in the 1970's left farmers unprotected from the sweeping economic changes that came with the new decade.

As the value of the dollar rose, the competitive position of the American farmers has weakened, and one other thing we have to remember is that the price supports legislated in the 1981 farm bill effectively priced many of our U.S. products out of the world market, and perhaps encouraged competing food producing nations to expand their production. Yet, despite the drop in our exports and a stagnant domestic demand, U.S. farm output has continued to grow in the 1980's. In effect, farmers have made use of the capacity built up during the seventies but, unfortunately, production has been more in reponse to Government price supports than to market signals. This continuing imbalance between the productive capacity and demand is a major cause of today's financial problems in agriculture. We have low commodity prices as a result and substantial excess capacity.

Now, this financial stress in the agricultural sector has not only caused more farm failures, but also has contributed to failures by nonfarm rural businesses. As farmers attempt to cope with lower commodity prices and declining asset values, the financial viability of farm machinery firms and other agricultural input suppliers is threatened. In addition, the drop in farm income also affects retailers serving heavily agricultural areas as farm families reduce their discretionary spending.

Unfortunately, while it seems certain that farm failures are on the increase, we do not have good data to provide pure estimates of this increase. Data do not exist specifically for farm failures nor do we know for sure the causal factors determining these failures. Information on business closures and failures is not systematically collected for all sectors of the economy. Data that do exist are based on statistically biased samples that tend to exclude many smaller firms. There are, however, reliable data on the number of total bankruptcies, but no information on how those bankruptcies divide out between farmers and farm-related businesses for instance.

According to U.S. court records, bankruptcies of businesses reached a previous peak in 1982 when nearly 66,000 businesses went through bankruptcy. Business bankruptcies subsequently declined during the second half of 1983, but have risen again in 1985. Dun & Bradstreet data show similar patterns. The American Bankers Association periodically conducts surveys of local bankers. Based on those surveys, it appears that 4.8 percent of the farms went out of business, 3.8 percent went through bankruptcy proceedings.

While these percentages do not yield an accurate nationwide estimate, they do quite clearly indicate the direction of the trend, and that is upward.

Another indicator is a survey of county extension agents in 20 agricultural States. This year 55 percent of those extension agents believe that the number of farmers who went out of business due to financial stress was higher during the second quarter this year than it was 1 year ago.

Analyses by the Small Business Administration also show a large increase in the total number of bankruptcies in 10 States which SBA defines as agricultural States. For the 10 State area, bankruptcies in the first 5 months of 1985 totaled 6,416. That is up 29 percent from the same period a year ago. By comparison, bankruptcies only increased 4 percent for the remainder of the Nation. So that tells us that there is an increasing late of bankruptcy in these agricultural areas.

A couple of very general comments about the treatment of farmers in the bankruptcy proceedings. Under U.S. bankruptcy law, a farmer is defined as any person, partnership, corporation, cooperative, or other business entity that receives more than 80 percent of its gross income from a farming operation during the preceding taxable year. A creditor cannot institute an involuntary bankruptcy proceeding against a farmer nor can a creditor force the conversion of a voluntary chapter 11 reorganization or a chapter 13 adjustment of debts case to liquidation under chapter 7. In theory then, these provisions would afford farmers some more protection from dissatisfied creditors than is enjoyed by nonfarm businesses.

But this special treatment aside, Federal income tax provisions often force farmers to file bankruptcy in order to liquidate their assets. Most farmers use the cash method of accounting rather than the accrual method used in nonfarm businesses. As a result, most income raised through the liquidation of livestock and crops is taxable for income tax purposes. In addition, the sale or transfer of property to satisfy outstanding debt can trigger a host of tax recapture mechanisms.

As a result of these tax consequences, there may be a higher incentive for farm liquidation to be handled through formal bankruptcy than is the case in the nonfarm sector.

Mr. Chairman, the next section of my statement pertains to the financial condition of rural banks, but in the interest of time I would like simply to submit that for the record and proceed with concluding comments.

Senator **Grassley**. Are you about finished?

Mr. **Wilson**. Yes, sir.

In concluding, I think it probably is appropriate to remind ourselves of one thing, and you have alluded to this, Mr. Chairman and the witness before me referred to it. The economic fate of most rural communities and firms depends to a very great extent upon macroeconomic policies. The dollar exchange rate and the interest rate—both key economic variables—have a profound influence on the health of U.S. agriculture, and therefore rural America. For this reason, no matter what else happens, deficit reduction is an essential prerequisite for the recovery of the farm and rural sectors of our economy.

Thank you, Mr. Chairman, that does conclude my statement.

[Statement follows:]

PREPARED STATEMENT OF EWEN M. WILSON

Mr. Chairman and members of the Subcommittees, I appreciate this opportunity to appear before you to discuss the current financial conditions of farm and rural businesses.

The farm sector is in the midst of a difficult financial and structural transition. Forecasts suggest little prospect for improvements in demand for farm products sufficient to justify the high prices paid for farm land in the late 1970's. As a result, those farmers who bought land through debt financing now are experiencing significant financial stress. Further, farmers' financial problems have spread to the agribusiness sector and rural communities generally, both directly through farmers' reduced purchasing power and, indirectly, through the farm sector's adverse affect on rural lenders.

The current financial conditions of farms, nonfarm rural businesses, and rural lenders are all interrelated, at least in agricultural areas of the country. In my statement, I will review developments in the agricultural sector as well as the impact these developments are having on commercial banks in rural America.

Farm Financial Conditions

While most farmers are in tolerable financial condition, USDA's January 1985 Farm Cost and Returns Survey indicated that 10 to 12 percent of farm operators were in serious financial stress as measured by the combination of a high debt/asset ratio and a negative cash flow. Developments since January in commodity and land markets suggest that the farm financial situation has worsened. There is little likelihood that many of these farmers can, on their own, solve their current financial problems and remain in farming.

Financial problems in the farm sector reflect an inability to service the existing interest repayment and debt load of the sector from total operator earnings. These problems have been made critical by a fundamental downward adjustment of asset values. Nearly $150 billion in owner's equity was lost through land value depreciation between 1981 and 1985. This reflects a nationwide decline in the value of farmland of 19 percent during this four year period. In the Midwest, annual USDA surveys have documented much larger declines in the average value of farmland over this period. Recent surveys by several Federal Reserve Banks indicate that land values have fallen further in some parts of the country, particularly in the Midwest, during 1985. We have reached the point where owner's equity (principally in land) can no longer shield the sector from its inability to repay its debts from current and expected future earnings.

To understand today's situation, we need to look at the so-called "boom" years of the 1970's when U.S. agriculture saw tremendous rates of growth. Farm exports grew five-fold to a record $44 billion in FY 1981. Farmers planted fence-row to fence-row, and bankers enthusiastically financed the expansion. An additional 55 million acres of U.S. cropland came into production, average yields increased by 30 percent, and hundreds of millions of dollars spent on machinery and equipment appeared to herald a new era of financial security for rural America. Rising farm incomes paid for some of this investment, but farmers financed the bulk by borrowing. Farm debt rose from about $50 billion in 1970 to $130 billion in 1980 and reached $212 billion in 1985.

Financial conditions in the 1970's offered a powerful rationale for buying real assets such as farmland. Farmers and others eagerly sought farmland as a hedge against inflation, and for a while they weren't disappointed. The average value of farmland increased by more than 13 percent annually during the 1970's. Although nominal interest rates were on the rise, real interest rates were low and even negative at times. The combination of a strong export market and high inflation reinforced demand for farmland.

But almost overnight, world recession slowed the growth in demand for farm products, halting the incredible gains in trade. Inflation was brought under control, but ony with record high real interest rates. Coupled with declines in producer returns, these factors led to a downward adjustment in land values. Aggressive expansion in productive capacity and in debt in the 1970's left farmrs unprotected from the sweeping economic changes that came with the new decade.

As the value of the dollar rose, the competitive position of the American farmers weakened.on the world market and other cuntries expanded their agricultural output. The appreciating dollar combined with rigid price supports legislated in the 1981 Farm Bill effectively priced many U.S. products out of world markets and encouraged expansion in competing exporting nations. Yet, despite the sharp drop in trade and virtually stagnant demand for the past 3 to 4 years, U.S. farm output has continued to grow in the 1980's. Farmers have made use of the capacity built up during the 1970's, but production has been more in response to Government price supports rather than to market signals. This continuing imbalance between productive capacity and demand is a major cause of today's financial problems in agriculture. Expanding production and declining exports have led to low commodity prices and substantial excess capacity on farms, in the farm input industry, and in farm export industries. This, coupled with steep declines in farm asset values, has pushed some farmers out of farming, left many others in precarious financial condition, and reduced employment in farm related industries.

Many of the adjustments currently occurring in the farm sector are moving it toward a cost and debt structure that are more compatible with the bearish market environment of the 1980's. However, adjustments in the farm sector are not completed. Given near-term prospects for commodity prices, continuing productivity improvements, and limited growth in demand for U.S. farm products, the production capability of the farm sector exceeds current market demands. A further downscaling of farm sector resources is likely, but not all of the effects will be limited to individual farmers and their families.

Farm and Rural Business Failures

Financial stress in the agricultural sector has not only caused more farm failures, but has contributed to failures by nonfarm rural businesses as well. As farmers attempt to cope with lower commodity prices and declining asset values, the financial viability of farm construction and machinery firms, and other agricultural input suppliers, is threatened. In addition, the drop in farm income also affects retailers serving heavily agricultural areas as farm families reduce their discretionary spending. As a result, current problems within the agricultural sector have adversely affected the general rural economy, especially in the Midwest.

Nonetheless, while it seems certain that farm failures are on the increase, the extent to which these failures contribute to an increase in nonfarm rural businesses failures is difficult to estimate. Data simply do not exist on farm versus nonfarm rural business failures, let alone the causal factors determining these failures. Information on business closures and failures is not systematically collected for all sectors of the economy. Data that do exist are based on statistically biased samples that tend to exclude many smaller firms. There are however, reliable data available on the number of bankruptcies, but no information on how many of these bankruptcies involve farmers and farm-related businesses.

According to U.S. Court records, bankruptcies of businesses were highest in 1982 when nearly 66,000 businesses went through bankruptcy. Business bankruptcies declined sharply during the second half of 1983, but rose again in the first half of 1985. Dun and Bradstreet data on business failures show a similar pattern except for the first two months of 1985, when failures dropped slightly. Since the business failure rate has a cyclical component which lags behind the regular business cycle, and since economic growth in the rural economy has lagged behind the rest of the economy recently, it seems likely that rural business failure rates will continue to increase even when the national failure rate turns down.

While the Federal government does not collect information on the number on farm bankruptcies, there are surveys which indicate that farm bankruptcies are on the rise. The American Bankers Association periodically asks local bankers to estimate the percentage of farms in their service area which ceased operating during the previous year, and the percentage which went through bankruptcy proceedings. For the year ending June 1985, the average of responses by those surveyed indicate that 4.8 percent of farms went out of business, and 3.8 percent went through bankruptcy proceedings. While these percentages do not yield a reliable estimate of the total number of farm bankruptcies, recent changes in the ABA's data probably indicate the direction of the trend. In both cases they indicate that farm failures are up sharply from those estimated for previous years, with an upward trend evident over the 1982 and 1985 period.

Based on a survey of county extension agents in 20 agricultural states, the Farm Financial Condition Review reported that 55 percent of the respondents with an opinion believed that the number of farmers who went out of business due to financial stress during the second quarter of 1985 was higher than during the same period a year earlier. Only 7 percent of the respondents believed the number of farm failures declined in 1985.

Analyses by the Small Business Administration (SBA) show a large increase in the total number of business bankruptcies in 10 "agricultural States" (Idaho, South Dakota, North Dakota, Nebraska, Iowa, Kansas, Missouri, Oklahoma, Minnesota and Kentucky) during the first 5 months of 1985 compared with figures from a year earlier. For the 10 State area, bankruptcies were up by 29 percent to 6,416 in 1985; by comparison, bankruptcies only increased by 4 percent for the remainder of the Nation. This pattern represents a signficant change from earlier years when the increase in bankruptcies within the 10 State area was closer to the national average. SBA researchers attribute this pattern to the growing numbers of farm and farm-related business bankruptcies.

Unfortunately, there is no way to isolate farm bankruptcies from other business bankruptcies in the SBA data.

Treatment of Farms in Bankruptcy Proceedings

Farmers generally are governed by the same rules under Federal bankruptcy laws as nonfarm businesses. However, in certain instances farmers are accorded special treatment. Under bankruptcy law, a farmer is any person, partnership, corporation, cooperative, or other business entity that received more than 80 percent of its gross income from a farming operation during the taxable year preceding bankruptcy. A creditor cannot insititute an involuntary bankruptcy proceeding against a farmer, nor can a creditor force the conversion of a voluntary Chapter 11 reorganization or a Chapter 13 adjustment of debts case to liquidation under Chapter 7. These provisions afford farmers more protection from dissatisfied creditors than is enjoyed by nonfarm businesses.

This special treatment aside, Federal income tax provisions often force farmers to file bankruptcy in order to liquidate their assets or restructure their debt. Most farmers use the cash method of accounting rather than the accrual method adopted by the nonfarm business sector. As a result, most income raised through the liquidation of livestock and crops is taxable for income tax purposes. This makes voluntary liquidation more expensive for farmers, forcing a higher percentage of farmers through formal bankruptcy proceedings. In addition, the sale or transfer of property to satisfy outstanding debt can trigger a host of tax recapture mechanisms. Repayment of credits and deductions previously taken for depreciation, soil and water conservation, land clearing, investment, and cost sharing payments may be required when property is voluntarily transferred. The alternative minimum tax can also cause severe problems for farmers who have farmland which has appreciated in value from the date of purchase. As a result of these tax consequences, there may be a higher incentive for farm liquidations to be handled through formal bankruptcy than is the case in the nonfarm sector.

Another issue involved in bankruptcy procedures which often causes problems for farmers is the treatment of assets controlled by joint farming arrangements, particularly landlord-tenant arrangements. The filing of bankruptcy by either party to such an arrangement raises doubts about the property rights to crop and livestock produced under the agreement. Since it is not uncommon for tenant farmers to enter into oral agreements with their landlord, or to describe the legal nature of their relationship in only general terms, a bankruptcy by either party can have serious and unintended consequences for the other party. While these problems are not unique to farming, the increasing incidence of farm bankruptcies could have a more pervasive impact where joint agreements are in effect.

Financial Condition of Rural Banks

Deterioration in the financial condition of farms and nonfarm rural businesses has affected rural lenders. As loan customers experience cash flow problems and fall behind on loan payments, the quality of lender loan portfolios deteriorates, loan loss reserves have to be increased, and profit margins decline. Adjustments by rural banks to these problems have implications for credit availability for rural businesses generally.

About 60 percent of the commerical banks headquartered in rural America are defined as "agricultural banks" by the Federal Reserve Board, meaning they have a higher than average concentration of agricultural loans within their loan portfolios. As a group, rural banks, and even agricultural banks, continued to show a strong equity and profit position through the end of 1984. Nonetheless, there are signs that the current financial problems being experienced by farmers are having a detrimental effect on some agricultural banks.

In 1984, loan charge-offs at agricultural banks amounted to 1.2 percent of total loans outstanding -- a rate more than double that experienced by other small banks, and nearly six times the charge-off rate experienced by agricultural banks before the farm crisis. While the aggregate figure doesn't appear overly large, 12 percent of agricultural banks reported negative net income for 1984. Since 1981 there has been an eight-fold increase in the number of annual bank failures, with much of the increase coming among agricultural lenders. As of October 31, 94 commercial banks have failed in 1985 -- a post-depression high. According to the Federal Deposit Insurance Corporation, 49 of the failed banks were agricultural banks (25 percent or more of their loan portfolio in agricultural loans.) Nonetheless, these numbers are far below the 600 bank failures recorded annually during the 1920's.

While bank failures dramaticaly portray the problems being experienced by farm lenders, they generally do not have a serious impact on the availability of banking services within rural communities. Based on Federal Deposit Insurance Corporation data on insured banks, the majority of failed rural banks are reopened under new ownership. More troublesome from a credit availability point of view is the growth in the number of agricultural banks experiencing serious financial problems. As banks make adjustments in their lending decisions to deal with weaknesses identified by bank regulators, "marginally qualified" borrowers are likely to be denied credit.

Between January 1, 1983 and September 30, 1985, the number of agricultural banks on the Federal Deposit Insurance Corporation's "problem bank" list increased by nearly 170 percent; the rate of increase among other commerical banks over this period was 35 percent. The FDIC places a bank on its problem list when it determines that substantive corrective action is needed to prevent the bank from failing. As these "problem" agricultural banks attempt to cover bad loans, the availability of credit to exiting customers and to new businesses may be reduced. As a result, the number of farm borrowers facing foreclosure can increase as the bank attempts to correct its problems, and in areas with a high incidence of problem banks, a lack of local credit may become an impediment to future growth.

Summary

As a consequence of agriculture's important linkages to the local economy, economic stress in agriculture and among agricultural lenders will lead to an overall unfavorable business climate in many farming communities. These problems will limit some communities' ability to attract new economic activities or retain existing firms. Of 702 farming dependent rural counties, nearly half (339) lost population in the period 1980 to 1984. As a result of these population declines and therefore, of a reduced tax base, financial support for local government services will also be affected. Schools are particularly vulnerable, since a high proportion of local tax revenues are spent on education.

In conclusion it should be noted that the economic fate of most rural communities and firms depends to a great extent upon macroeconomic policies. The exchange rate of the dollar and the interest rate -- both key macroeconomic variables -- have profound influence upon the health of rural America. For this reason deficit reduction is an essential prerequisite for recovery of the farm and rural sectors of our economy.

Table 1. Farm and U.S. Business Failure Indices

Business failure index	1985	1984	1983	1982
		——Number——		
U.S. Business bankruptcies a/	35,542	63,378	61,612	65,807
		——Percent——		
Change in annual rate of bankruptcies a/	8.0	2.9	-6.4	38.4
Estimates of Farm Failures				
Farmers in bank lending areas who went out of business (during year ending in June) b/	4.8	3.8	2.3	2.2
Farmers in bank lending area who went through bankruptcy (during year ending in June) b/	3.8	2.6	1.1	0.8

a/ Source: Administrative Office of the U.S. Courts, Statistical Analysis and Reporting Division. Bankruptcies for 1985 are through June; the percentage change for 1985 is based on the comparable period a year earlier.

b/ Source: American Bankers Association mid-year Farm Credit Survey.

Table 2. Problem and Failed Commercial Banks

Date	Problem bank count			Failed banks (year to date)		
	Total	Agricultural a/		Total	Agricultural a/	
	—Number—		Percent	—Number—		Percent
12/31/83	603	146	24.2	44	7	15.9
12/31/84	800	288	36.0	78	25	32.1
09/30/85	1007	390	38.7	85	46	54.1
10/31/85	na	na	na	94	49	52.1

na—Not available

a/ An agricultural bank is one with 25 percent or more of its loan portfolio in agricultural loans. Problem bank counts represent the number of commercial banks on the FDIC's problem bank list on the date indicated. The number of failed banks include all commercial bank failures for the period January 1 until the date indicated.

Source: Federal Deposit Insurance Corporation.

Senator GRASSLEY. Thank you very much.

The bottom line then is that basically you do not have a view on this legislation, right, from the Department?

Mr. WILSON. No, we do not, sir.

Senator GRASSLEY. OK.

I guess I would ask, as something you can submit in writing, for the administration to take a point of view on it. It seems like, and what I am going to say now obviously cannot apply to you as an individual but to the U.S.D.A. of this administration generally, but it seems to me like whether it is this bill or whether it is hoping that we would have some sort of plan from the administration in regard to the farm credit situation generally, or the Farm Credit System specifically that we would have some sort of plan in these areas from this administration.

Now, this administration does have a plan that is going to cause more farmers to go into bankruptcy and write off 20 or 30 percent of the farmers, and that is basically their support for a program to pull the safety net out from under agriculture. And that is basically what this administration's program does through the dramatic reduction suggested in target prices. And if you put forward a plan for destroying agriculture, forcing people out of the business, Congress basically is going to reject it. The sooner the administration wakes up to that, and gets onboard with helping find a solution to the problem, the better off we will all be.

A recognition what sort of a farm bill we are going to have is basic to solving this problem generally. I would applaud the administration to the extent which they are already onboard and trying to reduce the budget deficit, except in the area of defense where they just want to continue to waste money. But except for defense, I would say this administration is pretty much onboard in getting interest rates down and getting the value of the dollar down. But they are going to undo all that by pulling the rug out from underneath the farmers through a bad farm program that they were supporting; then forcing 20 or 30 percent of those people out of farming, at least in my State.

And so I would ask USDA to have a plan in this area. It is very important that we have the USDA's views on this legislation. And what I guess is the ultimate inconsistency within this administration, they send Secretary Baker to Seoul 1 or 2 weeks ago with a fantastic plan for helping debt-ridden underdeveloped nations and the problems of international debt, the ripple effect that that is going to have through our banking community if our major banks go under. But the same newspapers that reported this outstanding plan, quoted Secretary Block, as saying he does not know what we are going to do with farm credit problems.

I would like to have as much consideration from this administration for the family farmer who is subsidizing consumers' food bill by 40 percent; who is giving consumers the best quality food in the world for only 15 percent of that consumer's income, lower than any other consumer spends anywhere in the world.

I would like to have the same consideration by this administration for the American farmer and the debt situation, as we give to billions of citizens of underdeveloped nations through what is a very sophisticated, and decent, plan to help with the international debt situation. That international debt situation is not any worse than the total debt situation of the American farmer. If half of the world's population can get some consideration from this administration on an international debt situation, the roughly 6 or 7 million people in agriculture ought to be able to get some sort of equal treatment from this administration, and we are not getting it. And we ought to get it. And I think when they send you up here without an opinion on this bill, and I do not hold you responsible for that, I am just giving you a message to take back, it seems to me like this is an example of that same ill-consideration of agriculture. I think probably you personally would have a very sympathetic view toward agriculture.

But somewhere down there, in OMB, in the White House, and then in the Secretary's office, there is not the consideration for agriculture we ought to have.

Now, I have some questions if you would permit me to ask them.

Given the bleak outlook you project in your statement, and it is both very bleak and very accurate, and, I would think based on that statement, we would get more action from the Department with a solution to the problem. But does this not tell you and the Department that we need to do something at the bankruptcy end of the farm credit crisis?

Mr. **Wilson**. Well, I am not sure, Mr. Chairman, about specifically the bankruptcy area. It would be somewhat presumptious of me to comment on the specific legislation that you have been considering today and, of course, you did invite me up here to comment on the general economy which I am perhaps better qualified to do than talk about the specific aspects of these bills.

I did listen to the earlier expert witnesses and noted that they were urging some caution in the way in which we proceed. And I could only remind you that there are some important legislative initiatives that have been undertaken. First of all, deficit reduction is critical for the well-being of agriculture. The 1985 farm bill is also critical. Over the previous 4 years, we have spent an all-time record amount of taxpayer money, and that does not seem to be stemming the losses in the farm sector. So we probably have to think about doing something different, but it is difficult to figure out exactly what.

Senator **Grassley**. Well, your Department's answer to that is a farm program that is going to just make a political decision, not an economic decision, to write off 33 percent of the farmers.

Mr. **Wilson**. I would disagree with that. I think it is imperative that we do get loan rates down to where we can be competitive in the world market. Without doing that, we will continue to lose farmers over the long range. We somehow have to change the structural characteristics of the market so we can compete with the South Americans and the Australians.

Senator **Grassley**. At the same time, we are letting the Japanese push us around on all our bilateral negotiations. I do not know whether that is going to get us much anyway.

We do have a letter that the Secretary sent to Peter Rodino, the chairman of the House Judiciary Committee, dated June 26, expressing opposition to two earlier House bills. And I would like to note that June 26 is 2 days after the House passed H.R. 2211. Do you know of any changes in policies or attitude at the USDA about whether bankruptcy laws ought to be changed to help the farmers especially with reference to the second paragraph of the letter, which says that the Department does not recommend enactment of either bill, and that refers to H.R. 1397 and H.R. 1399.

Is there any change in the position of the Administration then? You did not state opposition to H.R. 1397 or H.R. 1399. The bill that eventually passed the House came out of these two bills, which in turn is the same as one that Senator Heflin put in.

Mr. **Wilson**. Senator, I am not aware that there has been any change in the administration's position. I will checkup on that, and if there has been a change, I will get right back to you, sir.

Senator **Grassley**. OK. I have a couple of questions about special treatment for farmers.

In your testimony you stated that a creditor cannot currently institute an involuntary bankruptcy proceeding against a farmer.

Doesn't the Bankruptcy Code immunize only those farmers who derive more than 80 percent of their gross income from farming operations?

Mr. **Wilson**. Yes, that is my understanding. That is the definition that is applied. And I think the earlier witness referred to some of the problems with that definition.

Senator **Grassley**. According to the USDA's own statistics, most of the aggregate farm family income was from nonfarm sources. Doesn't tell you that, in reality, farmers do not get special treatment?

Mr. **Wilson**. Well, I think we have to look at the profile of the farmers in the country, and we have a total of something like 2.2 million farmers out there. Of those, about 600,000 or 700,000 are what would be referred to as commercial, full-time family farms. Most of those commercial farms, those 600,000 and 700,000, would derive most of their income from the farm. But they also are a group that has been heavily impacted by this financial stress.

Senator **Grassley**. Thank you very much.

Mr. **Wilson**. Thank you.

Senator **Grassley**. It is now my pleasure to call Mr. Fred Dumbaugh who is an attorney from Cedar Rapids, IA. I thank you, Fred, for coming, and I know that you understand these issues very well and how the issues you discuss today affect you as a lawyer, and also those farmers that you represent.

STATEMENT OF R. FRED DUMBAUGH, CEDAR RAPIDS, IA

Mr. **Dumbaugh**. Well, thank you very much, Senator, for inviting me to come and speak to you. I am deeply honored. I have previously furnished a copy of my testimony, so I will not read it at this time.

I would like to make a few comments I think on some points that have been raised here this morning.

In your opening remarks you indicated that at present it appeared to you that the farmer has basically four constructive things that they could do when they are faced with debt problems. One was to try to work out some sort of arrangement with their creditors, the other three had to do with bankruptcy, chapters 7, 13 and 11.

That is exactly what I tell my clients when they come in to see me. And we handle an exclusive bankruptcy practice. We represent primarily debtors, and we have pending, I believe, a little over 120 chapter 11s right now in the bankruptcy courts of northern and southern Iowa. We tell the debtors that they basically have one other alternative too and, unfortunately, Senator, it is the most popular. And that is the do nothing approach or play like an ostrich, put your head in the sand and pretend like nothing is going to happen, and wait until the walls fall in around you. And that, unfortunately, is the solution that most farmers in my observation have been taking.

They take that because they are fearful about, I think, what outlooks they can see in bankruptcy, and also because they have tried normally without success to reorganize outside of the context of bankruptcy. The very best solution in my observation is to keep the reorganization of farmers out of bankruptcy court and to have that done in a negotiating setting between the creditors and the debtors. Unfortunately, or I should say fortunately, we have found more and more general lenders and bankers agreeing to negotiate with farmers in the last year. We have had almost universal opposition to it by the Farm Credit System lenders, the Federal land bank and the Production Credit Association. Obviously if you cannot get these people in your camp to negotiate outside of bankruptcy, what are your alternatives?

Senator **Grassley**. You understand they were formed to serve farmers?

Mr. **Dumbaugh**. That is the theoretical purpose.

Senator **Grassley**. Some of us wonder when they are going to start.

Mr. **Dumbaugh**. Right. Well, I have not seen too much of that so far.

So the farmer really has no choice other than to go into bankruptcy. Let me say unequivocally, Senator, that chapter 11 will work in farm reorganization cases. We have over 30 of them that have been confirmed so far. Every single one of them are working to the best of my knowledge. They have not called and said it has not worked. And we have many more on the skids going through confirmation and——

Senator **Grassley**. You say that you have 30 that are working. Now, that is entirely different from what we have been led to believe, that 90 percent of those end up in chapter 7.

Mr. **Dumbaugh**. Well, now, we have not had that. We have had I think——

Senator **Grassley**. Has there been enough time for you to feel secure in what you are saying, that they are going to make it?

Mr. **Dumbaugh**. Well, we look at a successful plan as one that is completed totally. And some of these call for amortization anywhere from 10 to 30 years down the road. And so we will not know that. But right now they are working and they have been confirmed. And the farmers are still in business, and it appears that they are able to meet their planned debt service.

I might also indicate we have never had a case that has had to be crammed-down. We have been able to negotiate after getting into bankruptcy court in all of the cases that we have had confirmed. Now why we could not do that before, I will never know. But after we get into bankruptcy court, we seem to be able to get an agreement with creditors, Farm Credit System creditors that we could not get beforehand.

One of the biggest problems in confirmation, and I think that Senator Burdick's bill would lend itself to, is the idea of cram-down if that is necessary. So far my office has not found it necessary, but I am sure we will. And the problem, as I see it, is really with the absolute priority rule. The rule that essentially says that if the farmer is going to keep any interest at all in anything, he has to pay all of the creditors that are senior to him 100 cents on the dollar. And the argument on the other hand is, well, if everything the farmer keeps is mortgaged for its equal value, he is really not keeping anything of value and, therefore, why should he have to pay his unsecured creditors, let us say, 100 cents on $1? Why could he not pay them 50 cents or 40 cents or whatever? In fact, in a liquidation perhaps they would not get anything. So maybe a 10 or 20 percent dividend would be appropriate.

We are running into differing opinions with differing judges concerning the absolute priority rule, and in the northern district of Iowa, since Judge Thinnes's illness and then subsequent death, we have had 12 judges into our district coming all the way from New Hampshire to New Mexico to hear cases. So we get a broad spectrum of judicial opinions in the Northern District of Iowa Bankruptcy Court, kind of like shooting craps as far as figuring out, you know, what is a particular judge going to do or not going to do in a situation.

I would also like to comment on your tax bill. And this is a problem that I think was alluded to by the man from the USDA here, and perhaps others, the fact that the tax situation literally keeps captive a farmer who may want to get out of farming. He cannot without picking up a substantial tax liability either in the form of a capital gain liability, a forgiveness of debt tax liability, or that nice alternative, minimum tax that can come in and whap you when you can beat the other two perhaps.

Senator **Grassley**. Now, did you hear me say that on that latter point we are trying to deal with——

Mr. **Dumbaugh**. Absolutely. And I think your bill is excellent, and I think your bill would certainly solve a lot of problems because if a farmer goes into a chapter 7 liquidating arrangement, what happens, if his capital assets are overencumbered—take, for instance, the example I cited in my testimony where a farmer in 1971 bought a farm for $500 an acre. The value of that farm over the next 9 or 10 years went up to, let us say, $2,500 an acre, which is realistic in Iowa, and then it has come down to $1,000 an acre at its present value. Well, while it was up at that $2,500 an acre level, that farmer went out and borrowed from our friendly Farm Credit people $1,200 an acre to perhaps expand his operation or whatever. So now the picture is——

Senator **Grassley**. Used to be the friendly Farm Credit.

Mr. DUMBAUGH. Used to be the friendly Farm Credit. I put that in quotes.

Now, the farmer has a 500-acre or $1 an acre basis land that is now worth a $1,000 an acre, and he owes $1,200 an acre on it. A trustee in a chapter 7 bankruptcy, where there are trustees in every single chapter 7 bankruptcy, is going to look at that and he is going to say I am going to abandon that property, kick it out of the bankruptcy because it has no equity for the benefit of the general creditors. So that property goes back out of the bankruptcy. Where does it go? It goes to the farmer. Now, what happens? The creditors come in, foreclose on the property, and there is your capital gain liability because that is a taxable event. And the IRS will come in and tax that farmer even though he is now going through a chapter 7, he has rid himself of his other dischargable debt, he has picked himself up a substantial tax liability.

I have seen potential cases like that come into my office where a farmer is looking at $70,000 to $80,000 worth of taxes.

Senator GRASSLEY. We ran into one $130,000 one.

Mr. DUMBAUGH. Yes, I have heard of that one, but I never saw it personally. But I think maybe someone mentioned it.

Another thing that troubles me about the bill dealing with the expansion of chapter 13, and personally I am in favor of expanding chapter 13. I would like to see the debt limits put up so that it could accommodate more farmers which is certainly does not now. By the way, the average debt picture in my office of a farmer is $750,000. And so we do not come anywhere near fitting into chapter 13 right now.

But it has to do with the trustee fee provision. There are no trustees in chapter 11. There can be, but in the northern district of Iowa, to the best of my knowledge, there never has been. So the debtor runs his whole show, so to speak, in an 11. In a chapter 13, you are going to have a trustee. And as I read how they calculate those fees, they can be up in the area of $50,000 to $60,000 for a chapter 13, and that is a lot of money even for a rich old Iowa farmer with all that nice black dirt out there. That is an awful lot of money.

There also is a bill, I think, that is—talking about it, it has to do with U.S. trustees, it has to do with raising the filing fees in chapter 11 under the formula based upon an asset value. The filing fee, just to file a chapter 11, could be up in the area of $5,000. And I think that is grossly excessive. That is denial of the court process to people that just cannot afford that sort of thing.

One other thing had to do with the liquidating plan fee misconception that a farmer cannot be taken into a chapter 7 involuntarily or cannot be converted from a chapter 11 to a chapter 7 is absolutely correct. But where creditors are now getting around that is by the right that they have if the debtor does not file his plan within the exclusive period, to turn around and file a liquidating plan. The liquidating plan in a chapter 11 is far more harmful to a farmer really than it would be if he was just allowed to go through a foreclosure. Because with a liquidating plan, he has no rights of redemption to take his property back within a year should he somehow or other find the tooth fairy and be able to come up with the money to pay the mortgage indebtedness.

And so creditors are getting around the inability to involuntarily liquidate farmers through a 7 or converting them to a 7 by just filing a liquidating plan. That is the same thing, in fact even better probably.

Thank you very much, Senator, for your allowing me to come here.

Senator **Grassley**. Thank you very much for your testimony. From the standpoint of a practicing lawyer, it is very beneficial to have your point of view . And, of course, we will be working with other lawyers as well in trying to find a solution to this problem. I have a few brief questions.

How important to providing relief is the House amendment that would enable a family farm debtor to modify a secured debt on a residence?

Mr. **Dumbaugh**. I do not think that it is particularly important.

Senator **Grassley**. How would you handle the fact that even extending chapter 13 repayment to 10 years, a residential mortgage commonly runs much longer than that and thus would not be a part of a 10-year plan?

Mr. **Dumbaugh**. I am not sure I understand your question.

I am very much in favor of the extension to 10 years, even though 10 years probably is not going to get the farmer out of the woods. We can provide a balloon at the end of 10 years for the debt presumably that is not taken care of, maybe amortize something over 30 but have a balloon at the end of 10 and utilize chapter 13 in that respect. If that involves the homestead part of the farmer's operation, as well as his productive land, it would be dealt with in that.

Senator **Grassley**. Do you have any view about whether the House bill amendments should apply to pending cases such as pending chapter 11's or chapter 7's to allow these parties to convert to chapter 13 as amended?

And also if your answer would be yes, or even if your answer is no, would you see any particular procedural problems that that would create?

Mr. **Dumbaugh**. I really do not have an opinion but I am going to give you one. I have not—you caught me offguard. I really have not given that much thought. I can see that there might be some constitutional problems with that. I think there may be some very serious legal questions with having it made retroactive to cases already filed prior to the time that it came into effect.

On the other hand, if you take an 11, let us say, or an 11 that is in effect right now and the new law comes into effect and you want to convert it to a 13, I guess you are starting basically some new proceedings so that procedure would operate and maybe you would not have the legal questions. Good point.

[Statement follows:]

PREPARED STATEMENT OF R. FRED DUMBAUGH

CHAIRMAN EAST AND CHAIRMAN GRASSLEY AND OTHER SUB-COMMITTEE MEMBERS:

I am honored to have been invited to appear before you and testify on problems facing "family farmers" in attempting to reorganize under existing bankruptcy laws. I am an attorney with over 21 years of practice experience and I am engaged in a specialized practice of Bankruptcy Law in Cedar Rapids, Iowa. I have been engaged in a specialized practice since 1983. It would appear that my decision to specialize my practice and limit it only to bankruptcy was perfectly timed, since the financial plight of the farmer seemed to gain great momentum at about that time.

Since 1983 my office, which at present employs 5 attorneys, and 5 legal assistants, has handled over 150 Chapter 11s for farmers, in excess of 100 Chapter 7s for farmers, and 3 Chapter 13s for farmers. We have obtained confirmation orders in over 30 Chapter 11s and in two of the three Chapter 13s. At present we have approximately 120 farm Chapter 11s pending and working their way toward confirmation. Although I have not added the numbers to arrive at an exact figure, I can represent to you conservatively that the average debt load of a financially distressed farmer whose case is in our office would be approximately $750,000.00 and the average present value of their assets would be at least $500,000.00. We have several cases pending in Chapter 11 where the farmer is engaged in farming several thousand acres of Iowa farm land, the largest being a farmer who farms 6,600 acres.

Without attempting to place any blame, it would appear to me that the cause for this financial plight of the farmers I deal with would fall into one or more of three categories. The first is weather, of which the farmer has absolutely no control. In Iowa, over the last five years, we have experienced some rather severe drought problems in certain parts of the state, and some parts of the state have experienced drought problems for two or more years in a row. The second category is interest. Once again, this is a category of which the farmer basicly has no control. During the "boom" years prior to 1981, everyone who was supposed to know anything about farming and agri-buisiness spread the philosophy that bigger is better. Relatively cheap money was available from creditors, particularly the Production Credit Association, and farmers were encouraged to expand their operation by buying more equipment, land, and livestock. The third category is prices. Farmers are in a unique position insofar as prices in that they essentially have no control over them and can do very little about them. Farmers can sell or buy on the commodity market, which in my experience very few of them do, or they can elect to keep their products off the market in hopes that the prices will increase.

The combination of one or more of the three above categories have, in my opinion, caused all of my present clients to end up in my office. Those clients that are presently or who have been in a Chapter 11 are, wihtout exception, experienced farmers who have in the past been frugal and good businessmen. Also without exception, they have waited to come into my office until their backs were against the wall and they had no other place to turn. This, I am sure in part, is due to the attitude among farmers that bankruptcy is immoral or otherwise bad and shouldn't be considered. Several of my clients have expressed to me that their fathers, during the great depression, worked for many years thereafter to pay back the banker fully and never had to stoop so low as to "file bankruptcy". Some of my clients have also expressed their understanding of the bankruptcy law to me by saying that the bankruptcy law does not cover farmers or the types of debt problems they have. When this attitude is expressed, I am quick to point out that the Bankruptcy Code does not exclude farmers, and as far as Chapter 11, specifically makes reference to farmers in Section 1112 where the Code refers to the fact that a Chapter 11 cannot be involuntarily converted to a Chapter 7 if the Debtor is a farmer.

The present Bankruptcy Code, which became effective October 1, 1979 and has subsequently amended, is an excellent law and clearly demonstrates the great time and foresight put into it by the members of Congress. Certainly, as with any law, there may be ways to improve it. In this regard, I think Congress already has its finger on the pulse by the bills which will modify the provisions of Chapter 13 as they relate to "family farmers", as well as make minor changes in Chapter 11 in that same respect.

It is said by some, including Bankruptcy Judges, that Chapter 11 cannot and will not work for a farming business. I respectfully disagree with this opinion. My past experience of obtaining Confirmation Orders in over 30 Chapter 11 farm bankruptcies, all of which are working, is support enough for my opinion. The problem, and probably the reason for most of the negative thought concerning the applicability of Chapter 11 to farm business, is the fact that all too often a Chapter 11 is filed in a case where it should not have been filed. Chapter 11 will not work in all farm business situations. It will work in some. The trick facing lawyers practicing bankruptcy law in this area is to be able to determine what cases will work in Chapter 11 and what ones won't. In my office, we have attempted to solve this dilemma by obtaining from our clients, prior to filing a Chapter 11, information necessary to evaluate the probable feasibility of a reorganization Plan. We require all of our clients, before filing, to furnish us with reasonable and conservative cash flow projections for the current year and the next two years. Through the use of computers, we can evaluate these cash flow numbers, modify them if necessary, and arrive at a bottom line number which will show us what sort of debt service load the client can handle as it relates to pre-filing debt. We also obtain from our clients detailed information concerning each of their debts, showing among other things the current interest rate, the principal balance due, accrued interest due, and the nature and extent of the security interest, if any, of the creditor. We then use the guidelines presently contained in the Bankruptcy Code in Chapter 5 and Chapter 11 and put together a "preliminary" Plan of Reorganization. If the debt service requirements shown in the "preliminary" Plan of Reorganization can be met by the cash flow numbers, the case has passed its first test and may be reorganizable. We then look to the long term ability of the Debtor farmer to retain the assets necessary to produce the income, in otherwords, to provide "adequate protection" to the creditor. The requirements in the Bankruptcy Code that the Debtor keep creditors "adequately protected" in order to avoid the lifting of the automatic stay provided in Section 362 of the Bankruptcy Code is probably the most serious problem faced by farmers desiring to reorganize under the provisions of the Bankruptcy Code. With the sharp decline in the value of agricultural land in Iowa over the last two years, it is not unusual for clients who filed Chapter 11 before 1985 to have experienced a decrease in land values of from 40 to 75 percent from the date they filed to the present. When these cases were originally filed, no one in their wildest imagination expected to see a decrease in land value in this amount. Most creditors who have security in the land in these cases have filed proceedings in the Bankruptcy Court seeking to have the automatic stay lifted so that the collateral can be foreclosed upon or taken back. This action is certainly justified on the part of the creditors. On the other hand, if the Debtor does not have a farm, he certainly cannot reorganize a farming business. Although not specifically required by the existing Bankruptcy Code, one solution which we have used in this regard is to provide in our Plan of Reorgnaization that we will pay the secured creditor, as a secured creditor, the value of the collateral on the date of filing, not on the date of confirmation as is the standard in the

Code. If the Plan of Reorganization appears to the court to be feasible in this regard, we have found that the court will approve such a Plan. Finally, we will calculate the client's debt to asset ratio at present and as we would expect it after reorganization. Although we feel that the income generating potential of the business is the single most important factor in determining whether or not reorganization is feasible, the restructured debt to asset ratio gives us information that will be relevant at the time of a confirmation hearing.

Once the information and analysis shown above has been obtained from the client, a knowledgeable decision can be made concerning the feasibility of reorganization. In the event reorganization is not feasible, it is absolutely essential the client be so advised. Filing a Chapter 11 on behalf of a farmer or for that matter, any client, which is a hopeless cause from the start or which is filed solely for the purpose of obtaining " a year or two" or which is filed because counsel feels "good times are right around the corner" is a disservice to the client and to the court. To date, my office has had only one case dismissed by the court, and that was a case where the client, without counsel's knowledge, deeded real estate to an alleged "trust" in the State of Oregon without court approval. We have had two or three Chapter 11s convert to Chapter 7 voluntarily, and we have had approximately eight Chapter 11 reorganizations change to a Chapter 11 liquidation. We have never had a case dismissed where the client was unable to put together a Plan of Reorganization.

As I have previously stated, in my opinion, the present Bankruptcy Code with its amendments is a very workable tool for farmers seeking to reorganize. However, certain changes could be made which would certainly improve it.

The major improvement could be made by a bill similar to H.R.2211 and S.1516. These bills deal with Chapters 11 and 13, but primarily with Chapter 13. The proposed amendments, which will greatly expand the ability to use Chapter 13 in farm reorganizations by increasing the debt limits and the time allowed for repayment, will in my opinion be a welcome change. Chapter 13 is substantially less complex and normally a faster procedure than Chapter 11. With the ability to use Chapter 13 for many farm reorganizations, in my opinion the creditors would not be as eager to have the automatic stay lifted since the ultimate outcome of the case will be rapidly forthcoming. It is also my opinion that substantially less attorney's fees will be generated by cases handled under Chapter 13 than Chapter 11. That advantage, however, will be overshadowed by the Trustee's fees provided in the bills. Since there is normally not a Trustee appointed in a Chapter 11 case, the Debtor-in-Possession continues to operate the business and to disburse payments, both to post-filing creditors as well as pre-filing creditors. This is not the case in a Chapter 13. My calculations of the fees to a Trustee which would be allowed in the average case in my office of $750,000.00 debt is a fee of $58,500.00. The largest fee my office has charged where a completed and confirmed farm Chapter 11 has been approximately $25,000.00.

Also under the two bills, no mention is made concerning "cash collateral" authority provided under Section 363 of the Bankruptcy Code and "secured debt authority" provided under Section 364 of the Bankruptcy Code. Presumably these proceedings would be required in operating Chapter 13s since in most farming situations, all of the inventory and products of the farm are subject to one or more security interests and further, in almost all circumstances, farmers need credit from time to time to plant their crop and to maintain their livestock herd. In Chapter 11, this authority is routinely obtained for the farmer at the front end of the case. Finally, as to Chapter 11, the bills provide a very needed extension of the exclusive period provided for filing a Plan of Reorganization. Changing the statute to provide an exclusive period of 240 days after filing to file the Plan and providing a 300 day period after the date of filing to obtain acceptances of the Plan from creditors would be a codification of what normally is done routinely, upon applicaton. It is virtually impossible to formulate and prepare a final Plan of Reorganization for a farmer much sooner than 240 days from filing. My experience has shown that most farmers will file a Chapter 11 between October 1 and March 31. After that time they are engaged in the planting and growing process, and because of the frailties of weather, it is anyone's guess how the crop will eventually turn out. This extension would allow for that problem and would at least get us well into the growing process before a Plan had to be filed.

One phenomenon which I have observed in the last year or so is the farmer who has "had it" and wants out but cannot get out. The present Internal Revenue Code provides for capital gain taxes and alternative minimum taxes in the event a capital gain on paper is received. The classic example of this is the situation where a farmer, in the early seventies, purchased Iowa farm land for $500 an acre. Over the next several years, through approximately 1980, the value of that land rose to a value of at least $2,500.00 per acre. While the land values were up, the farmer borrowed money in order to expand his operation. The loan balance at present is approximately $1,200.00 an acre or 50% of the value of the land at the time the loan was made. The present fair market value of the land is $1,000.00 an acre. Obviously, the farmer will not be able to find someone to buy the land for $1,000.00 an acre and to assume the additional $200 an acre mortgage indebtedness against it. If he did, he would incur capital gain liability of $500 per acre. On the other hand, if the farmer allows the secured creditor to foreclose and to eventually purchase the property at a Sheriff's Sale for the present fair market value of $1,000.00 per acre, the farmer may incur capital gain liability or alternative minimum tax liability for the capital gain of $500 per acre. The farmer cannot file a

Chapter 7 Bankruptcy in this situation and obtain relief from the problem since the Trustee in Bankruptcy will, in all probability, look at the present value of the land and abandon the land as having no equity. Then the foreclosure process previously referred to would take place and although the farmer would be discharged of all of his other dischargeable debts in the Chapter 7, he would pick up a substantial tax liability to the government which is non-dischargeable. AS I understand it, Senator Grassley has pending before the Senate a bill which would modify this procedure and which would provide the needed relief to the farmer who desires to "get out" but who at present cannot.

Finally, I would be derelict in my testimony to you if I did not comment on what appears to me to be the most serious problem with the use of the United States Bankruptcy Code for farmers in my district, the Northern District of Iowa. Through the 29th of October, 1985, I am advised that there were 2,267 filings in 1985 in the Bankruptcy Court in the Northern Disrict of Iowa. The highest total number of filings of that court in any previous full year were 1,819 cases. I am also advised that pending at present in that court are 604 Chapter 11s, and of these Chapter 11s all but approximately 50 are farm related. Chapter 11 cases are historically litigation producing, and coupled with the 604 cases are such companion actions as cash collateral proceedings, secured debt authority, motions to lift stay, motions to extend exclusivity, as well as disclosure statement hearings and confirmation hearings. The present law provides one judge to handle all of these cases. It is humanly impossible for one judge to handle these cases and some legislative relief should be passed in this regard.

I wish to thank the committees for the opportunity to appear before you and to express my thoughts and observations on this very important topic.

Senator **Grassley**. I do have three more questions that we will submit in writing.

[Information follows:]

United States Senate

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November 19, 1985

Mr. Fred Dumbaugh, Esq.
The Center
Ninth Floor
Cedar Rapids, Iowa 52401

Dear Mr. ~~Dumbaugh~~: Fred

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 6, 1985 concerning farm bankruptices.

Your response by December 2, 1985, to the following questions would be appreciated:

1. It's been suggested that too much time and resources of the farmer-debtor are spent, not in preparing a plan, but rather on staving off attempts to lift the automatic stay after the filing of a petition. Do you agree? If so, what specific amendments to the Code would you propose to limit creditor requests? Does limiting creditors requests raise Constitutional questions? Please discuss.

2. It appears that farmers have difficulty running their operations in the first weeks and months after filing, because of limits on the use of cash collateral. How serious a problem is this for farmers trying to reorganize? Would it be wise to amend section 361 to explicitly provide that priority crop liens are deemed adequate protection for the use of cash collateral? Would this solve the the farmer's problem in this area? Would it be fair to creditors?

3. A few bankruptcy courts have interpreted section 552(b) so as to release some property of the farm-debtor from the reach of security interests, thereby transmutting the proceeds from the sale of such property from cash collateral to simply cash for the debtor's use. *See*, *In Re Lawrence*, 41 B.R. 36 (Minn. 1984); *In Re Ydola Pigeon*, 13 B.C.D. 107 (N.D. 1985) (milk); *In Re Hamilton*, 18 B.R. 868 (Colo. 1982) (crops). Are these results fair and reasonable? Would it be wise to specifically incorporate the results in these cases into the Code?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck

CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
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December 27, 1985

Mr. Charles E. Grassley, Chairman
Sub-Committee on Administrative Practice & Procedures
Committee on the Judiciary
Washington, D.C. 20510

Dear Senator Grassley:

Please excuse my delay in answering your letter of November 19, 1985, concerning my testimony before your committee on November 6, 1985. It was my desire to perform some research on the questions contained in your letter of November 19th before replying, and I have just recently completed that research. I was also furnished a copy of a draft bill prepared by Judges Small and Moore of the United States Bankruptcy Court for the Eastern District of North Carolina.

I have reviewed the questions submitted to me in your letter of November 19, 1985, and I enclose herewith a memorandum which I prepared and which I hope adequately expresses my feelings and opinions concerning the questions.

I have also read and studied the draft bill prepared by the Bankruptcy Judges from North Carolina and I am tremendously impressed with it. I think it answers most, if not all, of the major problems that Farmer-Debtors are facing in connection with reorganization attempts and using the present Chapter 11 provisions. I think it blends the best provisions of Chapters 13 and 11 together and creates a very workable procedure for the unique type problems which we daily run into in agricultural reorganizations. I would strongly support legislation along these lines and in that regard, I certainly would be happy to assist you in anyway that I could to promote the bill.

I thank you very much for your attention to my testimony at the hearing on November 6, 1985, and your additional inquiries which I trust I have answered. If I can be of any further assistance to you or any members of the committee or your staff, please do not hesitate to contact me.

Very truly yours,

R. Fred Dumbaugh

RFD/jl
Enclosure

MEMORANDUM

1. IT'S BEEN SUGGESTED THAT TOO MUCH TIME AND RESOURCES OF THE FARMER-DEBTOR ARE SPENT, NOT IN PREPARING A PLAN, BUT RATHER ON STAVING OFF ATTEMPTS TO LIFT THE AUTOMATIC STAY AFTER THE FILING OF A PETITION. DO YOU AGREE? IF SO, WHAT SPECIFIC AMENDMENTS TO THE CODE WOULD YOU PROPOSE TO LIMIT CREDITOR REQUESTS? DOES LIMITING CREDITOR REQUESTS RAISE CONSTITUTIONAL QUESTIONS? PLEASE DISCUSS.

It is without question that a great deal of the time and resources of the Farmer-Debtor are spent in negotiations and litigation involving stay motions. By a large margin, stay motions consume more time and resources of the Debtor than any other aspect of the case. Often, these motions come at a very early time after the filing of the Petition, thus putting the Farmer-Debtor in an extremely difficult position. At such an early stage it is very difficult to form adequate protection for the creditor which will keep that creditor satisfied during the pendency of the case, and at the same time, not scuttle any reorganization efforts by making an overburdensome provision to satisfy one creditor. In one recent Chapter 11 case filed by this office, the Federal Land Bank filed its motion for relief from the automatic stay three days after the Petition was filed. It is inconceivable that the Federal Land officials were able to determine in that short period of time that the Federal Land Bank did not have adequate protection for its claim or that the Debtor had no equity and the property was not necessary to an effective reorganization. In many cases, a motion for relief from the automatic stay is a "knee-jerk" reaction to the filing of the Bankruptcy Petition. Many creditors see stay motions as a way to defeat the reorganization effort at an early stage, or to demand a "larger chunk of the pie" than they might otherwise get had no stay motion been filed.

The reason why the Farmer-Debtor must spend so much time and resources in combatting stay litigation is that there is so much "at risk" for the Farmer-Debtor should the movant prevail in having the automatic stay terminated. Obviously, if the movant is the mortgagee of the Farmer-Debtor's real estate then granting relief from the stay would allow foreclosure proceedings to be commenced or completed and the Farmer-Debtor would lose the real estate which is the basis for the operation. In like manner, if the movant is a bank, PCA or other operating lender then that moving party is likely to have a security interest in all of the personal property used in the farming operation. Relief from the automatic stay for this creditor would allow repossession or replevin actions that would strip the Farmer-Debtor of all the wherewithal to farm the land. The Farmer-Debtor's case can, therefore, be "won or lost" at a very early stage in the reorganization efforts, depending upon the outcome of stay litigation. Given the recent trend in case law interpretation of the requirements of adequate protection, the risk to the Farmer-Debtor increases each day. See, In Re American Mariner Industries, 734 F.2d 426 (9th Cir. 1984).

The new draft bill by Judge Small, proposing a new Chapter 12 for family farmers, appears to be a good way to "limit" the stay litigation currently being used by creditors. It would limit such requests because adequate protection is explicitly defined in that proposed bill. In this way, the Debtors would be sure that the protection offered would meet the requirements of the Bankruptcy Code and the creditors would have no grounds for arguing that such protection was not adequate. Another possible way to "limit" the requests for relief from the stay is to actually restrict the creditor's ability to make such a request. For example, it could be required that the creditor not be allowed to request relief from the automatic stay during the first sixty (60) days of the Petition, or that only one request could be made every 240 days. If such requirements were tempered by discretion in the Court to override these rules under unusual or extreme circumstances, then some of the prejudice to creditors could be alleviated. Another possibility, taking into account the current economic climate for farmers, would be to require the creditor to prove that the automatic stay is causing damage to the creditor. In other words, the law currently requires a Debtor to protect a creditor from damage resulting from the imposition of the automatic stay. If the decline in value of collateral is resulting from general economic decline, and if the creditor would not be able to protect itself from such decline even if the automatic stay were not in effect, then the creditor should not be entitled to some adequate protection payment, replacement lien, or other relief simply because the Debtor has filed a Petition under Title 11 of the United States Code. Such a provision would, however, be very complex and would require a great deal of thought before it could be implemented.

The limiting of creditor requests for relief from the stay does raise some constitutional questions; all of which seem to arise out of the "taking" issue. The argument by the creditors is that they have bargained for certain rights including the right to repossess the collateral which is security for the loan made to the Farmer-Debtor. They argue that if the provisions of the Bankruptcy Code prevent them from exercising this bargained for right, that their rights under the 5th Amendment to the Constitution have been violated by a taking of their property without due process. This argument is flawed in some respects and can be overcome by close analysis of the various constitutional provisions. See, Rogers, J. "The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the 5th Amendment and the Bankruptcy Clause" Volume 96, Harvard Law Review No. 5, p. 937 (March 1983). The "taking issue" perhaps can be avoided also by simply making the burden of proof more onerous on behalf of the creditors. In this way, stay litigation would be more costly to the creditor and less sure of producing results than it now is. Under that set of circumstances, the creditors are less likely to bring stay litigation at an early time.

On the whole, it appears that the best way to limit stay motions or to ameliorate their affect on the Farmer-Debtor is to explicitly define the terms "adequate protection" so that it is clear to both the creditor and the Debtor what will be required of the Debtor for the automatic stay to remain in effect.

2. IT APPEARS THAT FARMERS HAVE DIFFICULTY RUNNING THEIR OPERATIONS IN THE FIRST WEEKS AND MONTHS AFTER FILING, BECAUSE OF LIMITS ON THE USE OF CASH COLLATERAL. HOW SERIOUS A PROBLEM IS THIS FOR FARMERS TRYING TO REORGANIZE? WOULD IT BE WISE TO AMEND SECTION 361 TO EXPLICITLY PROVIDE THAT PRIORITY CROP LIENS ARE DEEMED ADEQUATE PROTECTION FOR THE USE OF CASH COLLATERAL? WOULD THIS SOLVE THE FARMER'S PROBLEM IN THIS AREA? WOULD IT BE FAIR TO CREDITORS?

After the automatic stay, this is the most serious problem facing the reorganization efforts of farm Debtors. Here again, what is "at risk" for the Farmer-Debtor makes the cash collateral issue an extremely delicate one for the Farmer-Debtor. To ensure continued operations, the Farmer-Debtor must have the ongoing use of funds for such things as feed for livestock, utilities and other ordinary expenses of operating. Additionally, once a Petition under Chapter 11 of the Bankruptcy Code has been filed by a Farmer-Debtor, he or she is often not able to continue making purchases "on account" and must pay cash in advance for purchases. This puts a further strain on the farmer's need for cash soon after the filing of the Petition. This absolute need for funds, coupled with delays in getting a hearing from the Bankruptcy Court, often put the Debtor in an almost untenable position from the very beginning of the Chapter 11 case. Because of the back log in the Courts in the Northern District of Iowa, any hearing to get Court approval for use of cash collateral may be six or eight weeks after the Petition is filed.

In some ways, the Farmer-Debtor is in a more precarious position with regard to cash collateral than with motions for relief from the automatic stay. This is true because the Farmer-Debtor has a fiduciary obligation to preserve the assets of the estate. Nevertheless, the Farmer-Debtor also has the prohibition against the use of cash collateral without agreement by the secured creditor or order of the Bankruptcy Court. The farm

Debtor most often has all assets secured to some creditor. If that creditor is unwilling for the farm Debtor to use cash collateral in any amount then the Farmer-Debtor is faced with the dilemma of either violating the prohibitions of Section 363 with regard to use of cash collateral or in violating his or her fiduciary obligation to preserve the assets of the estate. As a practical matter, these situation are often worked out by agreement with the secured creditor to allow a very limited use of cash collateral for the sole purpose of preserving the assets. Often this is very unfavorable to the Farmer-Debtor because the continued operation of the business is essential to produce whatever small profit may be available from those operations. In essence, a creditor's lack of cooperation on the use of cash collateral could squelch a reorganization effort before it ever really got off the ground. The other practical approach to this problem has been for the Debtor to approach the Bankruptcy Judge with a "emergency" application to use cash collateral. Unfortunately, the burden of cases on the Bankruptcy Judge for the Northern District of Iowa is far too well known. It is getting to the point where even emergency applications cannot always be heard in timely fashion. Further, it is somewhat ludicrous that the Code is structured in such a way that "emergency" applications become fairly routine with regard to the use of cash collateral.

Certainly a provision in Section 361 for a priority crop lien as adequate protection for the use of cash collateral would be a potential solution to this problem. It is doubtful that this solution would be the most optimum answer to the problem since such a lien may hamper the Farmer-Debtor's ability to finance crop inputs for the crop which will be planted during the pendency of the reorganization. This would be a good solution, however, if such a priority crop lien would stand as adequate protection until such time as the Debtor offered some other adequate protection in lieu of such a crop lien. Often, the practical result of cash collateral negotiations or litigation is that the secured creditor is given a replacement lien in the new crop to be planted. Certainly one of the "complaints" from creditors who are offered a replacement lien in new crop is that such a lien is much more speculative than the existing collateral or the "cash in the bank". In that respect, it might be necessary to require the Farmer-Debtor to secure the certainty of a crop by procuring crop insurance or through some other method commonly used in that area to ensure crop production.

Any legislation which would promote certainty in this area would be a large boon to farmers because of the uncertainty which proceeds the filing of any Chapter 11 case involving a farmer. In other words, if the farmer is assured that cash collateral use will be granted upon the filing of a Chapter 11 Petition, then it is much easier for the farmer to begin planning a reorganization of the outstanding obligations, rather than plotting the strategy necessary to "prove up" the adequacy of protection offered for use of cash collateral.

3. A FEW BANKRUPTCY COURTS HAVE INTERPRETTED SECTION 552(b) SO AS TO RELEASE SOME PROPERTY OF THE FARM-DEBTOR FROM THE REACH OF SECURITY INTERESTS, THEREBY TRANSMUTING THE PROCEEDS FROM THE SALE OF SUCH PROPERTY FROM THE CASH COLLATERAL TO SIMPLY CASH FOR THE DEBTOR'S USE. SEE, IN RE LAWRENCE, 41 B.R. 36 (MINN. 1984); IN RE YDOLA PIGEON, 13 BCD 107 (N.D. 1985) (MILK); IN RE HAMILTON, 18 B.R. 868 (COLO. 1982) (CROPS). ARE THESE RESULTS FAIR AND REASONABLE, WOULD IT BE WISE TO SPECIFICALLY INCORPORATE THE RESULTS IN THESE CASES INTO THE CODE?

These are good cases, well reasoned for the most part, and very fair because the continued operations of the estate, thus generating these new assets, should be for the benefit of all creditors not just those creditors who were in the bargaining position which enabled them to have the all encompassing language in their security documents. It does appear that it would be wise to incorporate the results of these cases into the Bankruptcy Code because there is a great diversity of opinion among the Courts as to how to interpret Section 552(b).

Surely it was not the intention of Congress to include crops within the language of Section 552(b); specifically the "rents and profits" language. Nevertheless, statutory clarity on this point would remove any potential controversies arising out of such an attempt by the Debtor to "release" this collateral. Probably the "hottest" issue regarding the interpretation of Section 552(b) is the extent to which "products" language in 552(b) includes the farm products produced after the filing of the Petition. Specifically, the issue whether milk produced post-petition would be a "product" pursuant to the definition of Section 552(b) so that the creditor's security interest would continue in milk produced after the filing. The Pigeon case gives a thorough and well reasoned analysis of the arguments for and against excluding milk from the products definition of Section 552(b). Certainly it appears that milk should not be subject to pre-petition security interest, especially in those cases where the pre-petition secured creditor does not in any way contribute to the production of the milk post-petition. If the secured creditor's cash collateral is used post-petition to fund the operations which lead to the production of the milk, then they are likely to get a post-petition security interest in the milk as a replacement lien for cash collateral use anyway. It would be a windfall to a secured creditor to allow the secured creditor to receive a lien in the post-petition milk produced when the burdens of cost and production of that milk come from assets of the estate or other secured creditors.

It would also be helpful to have the "escape clause" of Section 552(b) to be more liberally applied. In other words, there should be some statutory language added to that escape clause which directs the Bankruptcy Judge to override the exceptions in 552(b) whenever in the interest of justice or when the reorganization effort would be seriously impaired by continuation of the liens.

These changes would greatly aid Debtors without unduly burdening creditors. The Debtors also need, however, some remedy from the so-called "absolute priority rule". Farm Debtors are in the rather anomalous position of having too few unsecured debts. Because a farmer normally keeps trade debt fairly current, the largest unsecured claim in often held by the bank, PCA or Federal Land Bank as part of their overall claim which is only partially secured. Often, this creditor doesn't wish to remain with the Debtor and therefore will vote against the Plan as an unsecured creditor, hoping to force liquidation, because that creditor wants to realize on its collateral immediately rather than undergoing the reorganization process with the Debtor. This result has the effect of giving the secured creditor its collateral, by forcing liquidation, even though that creditor could not get relief from the automatic stay. The foregoing scenario reflects merely a good faith decision on the part of the creditor that it wishes not to be part of the reorganization effort. A similar scenario can develop when the creditor, even though acknowledging that a reorganization can be successful, does not wish to see the Debtor succeed for any number of what might be called "spite" reasons. This situation rarely occurs in other types of business reorganizations because other businesses usually have large numbers of unsecured creditors who hold no secured claim. In that circumstance, the unsecured creditors are often willing to take only a portion of the outstanding debt payment because a liquidation would produce little if any repayment of their outstanding claims. Therefore, the farm Debtor, as a result of being diligent in the payment of its unsecured debts is penalized through the interpretation of the code currently in force with regard to payment of unsecured claims.

Mr. **Dumbaugh**. Thank you, Senator, very much.

Senator **Grassley**. I want to call the next two witnesses as a panel. I know both of these gentlemen. I have known Ollie Hansen a little bit longer than I have known John Dean, but both are leaders in the banking community. They understand the problems of farmer and the entire economic situation for small town America. I want to thank them for being so patient. We have actually gone a little longer than we anticipated but we still have time to cover your testimony.

I would like to say that Oliver Hansen is representing the American Bankers Association, and he is president of the Liberty Trust and Savings in Durant, IA. And John Dean is with the Glenwood State Bank. And it is my understanding, John, that you are representing the Independent Bankers Association. You are chairman of a committee of the Independent Bankers, aren't you?

Mr. **Dean**. Vice chairman of the Ag Committee.

Senator **Grassley**. OK. Let us make that clear for the record. Because you are a leader in that area and speak for all independent bankers.

So I would like to have you proceed, Ollie first and then John.

STATEMENTS OF OLIVER HANSEN, PRESIDENT, LIBERTY TRUST & SAVINGS OF DURANT, IA, REPRESENTING AMERICAN BANKERS ASSOCIATION; AND JOHN DEAN, GLENWOOD STATE BANK OF GLENWOOD, IA, REPRESENTING INDEPENDENT BANKERS ASSOCIATION

Mr. **Hansen**. As John said, age first. So thank you, Senator.

Senator **Grassley**. Well, he will be there some day.

Mr. **Hansen**. I am Oliver Hansen, and I am president of Liberty Trust & Savings Bank in Durant, IA, a $52 million asset bank. I am also director of a bank in northeast Iowa.

As former chairman of the Agriculture Bankers Division, member of various committees, also as a former superintendent of banking in Iowa, and having farming interests, I am familiar with the farm problems. I do represent the American Bankers Association today, which represents over 95 percent of the commercial banking assets in this country. And I appreciate the opportunity to testify at this joint hearing.

Before going on, I would like to say this, that on two occasions we have met with Congressman Leach in Iowa regarding the problems of bankruptcy and also recently had the opportunity to visit with Congressman Tauke about the bankruptcy problems because these are serious problems.

In the interest of saving time, I am skipping over a good part of the testimony that has been prepared and been submitted. However, there are certain portions that I would like to refer to before going into the summary.

First, the number of problem banks reported by the FDIC has increased substantially—from 369 in 1982 to 1,032 in 1985. The FDIC's list of problem banks now includes 410 farm banks. In 1983, only 6 of the 44 bank failures were agricultural banks, a total of 14 percent. In 1984, 32 of the 79 bank failures were agricultural banks, or 41 percent. As of November 1, 1985, 95 banks have failed, 48 to 51 percent were agricultural banks. And, Senator, I fully agree with you, if we do not have some type of price stability to prevent land, machinery, and other commodity prices from dropping any lower, we "ain't seen nothing yet."

Senator Grassley. I would like to have you stop by and talk to the Republican leadership of the Senate on that point.

Mr. Hansen. Well, I wish it would do some good.

As I recently wrote to the Iowa congressional delegation, I appreciate the efforts of the Iowa congressional people in doing what they can for our Iowa farmers.

Senator Grassley. But you see, nobody out there or nobody here thinks things are going to get any worse. You have got to live with it like you do for that realization. And any way you can hammer that home here in Washington, you will be doing not only farmers but the entire economy of this country a great service.

Mr. Hansen. Perhaps if we had as much media coverage a couple of weeks ago when I participated in a panel for the Mental Health Society of Iowa Community Mental Health Group, there would be a better realization of what is going on in rural Iowa.

I do want to refer very briefly to an area in which Congress could be very helpful and that, Senator, is a bill that you have introduced, the alternative minimum tax legislation, S. 418, which has been referred to the Senate Finance Committee and included as an amendment in the 1986 Budget Reconciliation Act.

In attempting to work out a plan for a bank writeoff of a farmer's debt, the problem of "paper capital gains" continues to obstruct reaching a satisfactory solution between the lender and the farmer. We have gone through two of these processes, one involved a 3-year contract. And we definitely have to have legal counsel when we become involved. We wish you the very best of success in that venture.

Another thing I would like to mention specifically is that if there are problems with chapter 11 process, which impede the ability of the family farmer to effectively use the system, extending the timeframes for filing a plan simply delays the problem, rather than curing it. Extensions of filing are routinely granted and in fact the practice might even be abused somewhat today.

One problem that any participant in the bankruptcy process must be aware of is the acute shortage of bankruptcy judges. In Iowa, there are those two bankruptcy judges for the entire State. This fact has been referred to before, and I am not going to dwell on it except to say that it is a most serious problem. And as you will recall, I did alert the Iowa State congressional delegation several months ago to this serious lack. The way in which Judge Thinnes was treated was unfair.

In summary, our initial reaction to the proposed pieces of legislation recognizes the concern in Congress for the financial problems of the family farmer. However, we are not sure at this point that amendments of this nature are needed to solve the problem. Really what we are talking about today is not solving the problem of agriculture.

General approval has been given to the proposal that farmers use chapter 13 to solve farm bankruptcy issues. Let me briefly address those aspects.

First, is chapter 13 less expensive and simpler than chapter 11? Our task force on bankruptcy could not answer in the affirmative primarily because under chapter 13 an attorney must still meet with the debtor to draw up schedules, develop a workable plan and attend all hearings. Further, the debtor and attorney must complete a disclosure statement to analyze the cash flow of the operation.

Second, is chapter 13 more flexible? From the farmer's standpoint, the answer appears to be yes. However, a basic premise should be addressed. A family farm is more like a business than an individual with a regular income. Generally, farm income is contingent upon when crops or livestock are sold. Credit advanced to a farmer is not based on income from a third party, but on the basis of the farmer's ability to convert the loan proceeds into a cash crop. When farmers need the protection of the Bankruptcy Code to reorganize creditors, who often have many thousands of dollars invested in the operation, creditors deserve the right to have input into the process.

There may well be ways to work within the existing chapter 11 framework to provide relief for family farmers that would be less disruptive than the chapter 13 process.

While in no way diminishing the gravity of the agricultural crisis, we are not sure whether expanding the scope of chapter 13 bankruptcy to include family farmers is an appropriate solution to the problem. The root of the problem may not be in the code itself. Congress may be attempting to address the symptoms of the agricultural problem through the code rather than finding the cure by increasing farm income.

Consumers generally have a steady income stream from a third party in the form of wages under chapter 13. When credit is extended to consumers, the income to fund repayment is separate and distinct from the debt. They are not interdependent. When a consumer seeks the protection of chapter 13, he has, by the code's definition, a source of regular income and the only real issue is the rescheduling of the existing debt burden.

This situation contrasts markedly with the chapter 11 business bankruptcy. In a business environment, a loan is made based on the perceived ability of the obligor to invest the loan proceeds in a business and produce the income for repayment. The management of the business, existing debt burden, future earning prospects are all critical considerations in deciding whether credit will be extended.

A few years ago we argued for a long time on regulation Z of the Banking Act and decided at that time that farming was indeed a business. And it seems redundant to go through that again.

There are some decisions to be made. Currently in the Senate version of the Farm Bill, there is a new legislative program to help reduce interest rates for the farmer who is able to reorganize, and which may help farmers avoid bankruptcy. Our Association supports this new program. In addition, the House/Senate 1986 Budget Reconciliation package includes a provision by Senator Grassley which would allow forgiveness of farm debt gained through paper inflation of land values.

Lenders and farmers have problems and it is a benefit to both to try and work out the situation to restore the farmer to financial health. Banks do this on a daily basis. However, in cases beyond recovery, if the borrower is not cooperative, the needs of the lenders and the value of the collateral must be protected. After all, banks lend depositors funds, and loan losses result in higher interest rates to other farm borrowers. Banks do not lend bank money. We lend depositors' money.

I would suggest that your staff and the GAO go out into the field, visit with various lenders on a one-on-one basis, and get the facts on how bankruptcies are being handled by the courts, lawyers and lenders in various areas. Some questions need to be answered. How many farmers who have filed under chapter 11 actually succeed? I wish that the success of the bank of which I am a director had been as great as the previous witness has indicated it was.

What are the legal fees involved and what court delays can be expected? How much security is depleted because of these delays? Should there be an immediate appointment of a trustee and should the trustee be mandatory right at the outset so there is an indication of what is on hand and what the inventory is. Where are the funds from the sale of collateral being directed? How heavy are the caseloads on the judges? Many questions need to be resolved before changes should be made by the U.S. Congress.

Senator, I appreciate the opportunity to testify on behalf of the behalf of the ABA. If there are questions, I will be pleased to try and answer them.

[Statement follows:]

PREPARED STATEMENT OF OLIVER HANSEN

Mr. Chairman, my name is Oliver Hansen. I am President of Liberty Trust and Savings Bank in Durant, located in East Central Iowa, and a member of the Board of Directors of Farmers Savings Bank in West Union, located in Northeast Iowa. My bank has $52 million in assets with a large portion of our loan portfolio devoted to agriculture.

I am also a former Chairman of the Agricultural Bankers Division of the American Bankers Association, and former Superintendent of Banking for the State of Iowa. Thus, I am very familiar, through personal experience, with the current problems in the agricultural sector of our economy.

I am here today representing the American Bankers Association whose members hold over 95% of the commercial banking assets in this country. Approximately 5,200 banks have 20% or more of their assets in agricultural loans. I appreciate the opportunity to testify before this Joint Hearing of the Senate Judiciary Committee on farm bankruptcy legislation.

Mr. Chairman, I don't believe I need to extensively review for you the current agricultural problem. The effects are displayed daily on the front pages of newspapers from coast to coast. It is not unusual to hear about farm problems. In most cases, these problems are corrected by normal economic cycles in the farm economy which cause the industry to rebound and recover. However, this time we have some structural changes occurring within the agricultural industry that normal economic cycles will not correct without massive social and economic dislocation. These problems threaten the existence of a significant percentage of farms and an unknown, but growing number of agriculture-related banks and businesses.

Allow me to summarize some key facts:

- o There are over 4,000 agricultural banks in this country (an agricultural bank is one with under $500 million in assets and over 25% of total loans in agriculture).
- o In 1984 loan delinquencies in nonagricultural small banks (under $500 million in assets) declined by 6%. In agricultural banks, loan delinquencies increased by 10%.
- o The number of problem banks reported by the FDIC has increased substantially: from 369 in 1982 to 1032 in 1985. The FDIC's list of problem banks now includes 410 farm banks.

- In 1983, only 6 of 44 bank failures were agricultural banks (14%). In 1984, 32 of 79 bank failures were agricultural banks (41%). As of November 1, 1985, 95 banks have failed, 48 were agricultural banks.

The concluding paragraph of a recent USDA report summarizes well the situation we are facing.

> "Bank failures are currently running at 10 times their average annual rate for the past three decades. Institutional lenders, depending on the proportions of their portfolios in farm loans, may not be able to absorb likely increases in the numbers and amounts of troubled farm loans over the next few years without severe problems, further increases in lender failure, and increases in the costs of credit to agricultural borrowers." ("The Current Financial Condition of Farmers and Farm Lenders", USDA, March 1985, pg. 28).

Economic problems of a size not seen for generations are wrenching farm life and rural communities across the country's principal food-producing regions. Fear and despair are spreading among hundreds of thousands of farmers who because of low commodity prices and overwhelming debt cannot continue to operate millions of acres of farm land. They are among the nation's 2.37 million farmers who are struggling to pay interest on total liabilities that have soared 63% since 1979 from $132 billion to $215 billion. The interest now totals more than $21 billion a year, while total net farm income averaged only $23 billion a year in the past two years. In addition to the new economic data, signs of the severity of the problem have been evident over the last few months in visits and telephone interviews with farmers, bankers, and rural merchants.

Mr. Chairman, let me make it clear that farmers and bankers are in this current economic condition together. Agricultural bankers are just as dependent on farmers for repayment of their loans as the farmers are on the bankers to finance their crops. The symbiotic nature of this relationship and the direct impact that farm bankruptcies have on the viability of farm lenders must be kept firmly in mind when analyzing these proposed bills. Any proposal that attempts to shift an inordinate portion of the economic burden to the bank is not a valid approach since the net effect will be to jeopardize both the viability of agricultural banks, and the continued availability of financing for all farmers.

Our Association is in full agreement with all the assessments of the dire problems of the agricultural economy. However, based on the evidence at our disposal, we cannot agree that these bills, S.1342, S.705, S.1516, represent a reasonable or necessary method of addressing any of these problems. In fact, the overall impact of the enactment of such legislation could very well have a negative effect on the farm economy. The problem of farm bankruptcy will need to be addressed through our monetary, fiscal and trade policies as well as the 1985 Farm Bill.

Summary of Proposals

Each of these proposals attempts to open a new avenue of relief for the family farmer under the Bankruptcy Code. Key elements of these three bills are as follows:

S. 1342

- Creation of a new class of "family farmers" eligible to file in Chapter 13. A "family farmer" is defined as having received, in the prior taxable year, 80% or more of his income from a farm operation owned or operated by his and having total debts of less than one million dollars.
- The Chapter 13 plan could extend the payment plans for up to 10 years (current limit is 5).
- A family farmer debtor could petition the court to delay commencement of payments for a reasonable time. (Current law requires payments within 30 days of filing).
- In addition, the bill would amend Chapter 11 to allow farmers up to 240 days to file a plan (currently 120 days) should they choose to file under Chapter 11.
- If a Chapter 11 debtor-filed plan is not accepted, creditors may not file a plan until 300 days after initial filing of case. (Current law - 180 days).
- Changing the existing Chapter 13 would allow a mortgage secured by the principal residence of a family farmer, that sits on the land used in the farming operation or within a reasonable proximity, to be modified in the bankruptcy process. Chapter 13 currently prohibits the modification of a mortgage secured by a principal residence.

S. 1516

- Creation of a new class of "family farmers" eligible to file in Chapter 13.
- The Chapter 13 plan could extend for up to 7 years.
- Provides adjustable time limits for the first payment on the farmers plan.

S. 705

- Creation of a separate subchapter of Chapter 11 for farmers.
- Some creditor protection from the normal Chapter 11, but a streamlined process, eliminating much creditor participation in the reorganization process.

- Corporations would not have access to the family farmer section of Chapter 11.

Thus, each bill is designed to facilitate "family farmers" access to the bankruptcy process.

To address this issue, ABA established a bankruptcy task force to evaluate the introduced legislation and report on the current situation in bankruptcy court. Our panel included attorneys from Iowa, North Dakota, Texas, Nebraska, Minnesota, and South Carolina. I have attempted to summarize their experiences and perspectives in the overall analysis of Chapter 11 and Chapter 13.

I. THERE MAY BE VERY GOOD REASONS WHY CONGRESS SHOULD NOT ACT, OR AT LEAST NOT ACT HASTILY ON THESE PROPOSALS.

A key factor that needs to be considered is the precedent set by establishing another limited constituency with special rights in bankruptcy. There are already other special groups that have special rights in bankruptcy (municipalities, railroads, etc.) under the Code. Each of these groups is fairly small, has unique characteristics, and longstanding public policy reasons behind its special status. We wonder whether these same characteristics apply to family farmers. If special exceptions are made this year in the Bankruptcy Code for family farmers, will we be back next year attempting to amend the Code to protect automobile dealers or homebuilders or some other special group which may be experiencing economic difficulties? This is a rhetorical question, but the potential for the Balkanization of the Bankruptcy Code is quite real.

These considerations are amplified if the real underlying problem lies not with the Bankruptcy Code itself, but with other players within the agricultural economy who are not demonstrating sufficient flexibility in helping to alleviate farmers' financial distress. We are aware of reports that in certain areas of the country farmers who otherwise may have been able to reorganize, have essentially been forced to liquidate due to the intransigence of a public or quasi-public lender. If, in fact, the source of the problem is an institution accountable in whole or in part to the federal government, other more expeditious and less sweeping remedial methods should be available.

Since mid-September of 1984, we have been working with the Agriculture Department to try and improve the FmHA guaranteed loan program. While not a complete success, in FY1985 this program loaned $1.7 billion to qualifying farmers: without this program, many farmers would not have planted crops in 1985. In addition, the Senate version of the 1985 Farm Bill contains an interest rate buy-down match in which USDA will reduce interest rates by 2% and lenders will match 2%. We find this is a very positive short term approach to helping those farmers who still have viable operations but who are caught up in the current financial crisis. We are continuing to cooperate with the Congress's legislative efforts and the Agriculture Department's efforts to educate the banking community in the use of the program.

I want to address briefly another area where Congress could be helpful. Senator Grassley, you have introduced alternative minimum tax legislation, S. 418, which has been referred to the Senate Finance Committee and included as an amendment in the 1986 Budget Reconciliation Act. In attempting a work-out plan or bank write-off of a farmer's debt, the problem of "paper capital gains" continues to obstruct reaching a satisfactory solution between the lender and farmer. The ABA Agricultural Bankers Division is on record supporting a concept as outlined in S. 418. This approach could be helpful in averting bankruptcy proceedings by eliminating the tax preference for some net capital gains on transfers of real property.

We must also consider the individual who would be effected by the legislation, the "family farmer", and ask whether this person is generally more like an individual with regular income, for whom Chapter 13 was designed, or more like a business, for which Chapter 11 was designed.

It has been my experience that farmers a million dollars in debt are generally of a size that they are and should be considered businesses. Even though the farm may be the sole or primary income for the family, the farm itself needs to be, and is in most cases, run like a business. If this is the case, we strongly question whether or not we should try and "shoehorn" agricultural businessmen into a form of bankruptcy designed for wage earners.

The Chapter 13 bankruptcy process was designed for individuals with a steady income who lose of their finances. The Chapter 13 trustee and the debtor sit down and work out a plan whereby the debtor's regular flow of income is, in large measure, transferred to the trustee who then, in accordance with the plan filed and approved by the court, allots an appropriate percentage of that income to each creditor under the plan. At the end of the plan, the debtor is relieved of the remaining debt, having, in many cases, paid off a large portion of his indebtedness through the Chapter 13 plan.

That situation contrasts markedly with the average family farmer with whom I am familiar. Many farmers have very seasonal income and fairly acute cashflow problems. In addition, they typically have fairly complex and intricate financing arrangements with several different creditors. Often, the family farmer needs bridge financing to "keep him going" between crops, and income at any time is dependent primarily upon the successful operation of the farm. These characteristics make the family farmer appear to be a businessman--not an individual with a regular income, for whom the Chapter 13 process was designed.

If Chapter 11 of the Bankruptcy Code was designed to handle the business bankruptcy and now presents deficiencies specifically related to the family farm business, we wonder whether it wouldn't be better to attempt to address the deficiencies within Chapter 11? S. 1342 does offer some amendments specifically related to Chapter 11, however, for the most part, they tend to address the time periods for filing a plan. If there are problems endemic to the Chapter 11 process which impair the ability of the "family farmer" to effectively use the system, extending the time frames for filing a plan simply delays the problem, rather than curing it.

It may be that specific circumstances exist which disadvantage the family farmer in the Chapter 11 process. However, before we attempt to move the family farmer into a whole new chapter of the Code, we should examine the feasibility of curative amendments to Chapter 11. It may be that it is not a viable alternative, but it should be examined. We need to remember that the ink is barely dry on the 1984 amendments to the Bankruptcy Code.

In 1980, the American Bankers Association was part of a coalition which came to the Congress in the wake of skyrocketing consumer bankruptcies subsequent to the enactment of the 1978 Bankruptcy Code Amendments. We, at that time, pointed out deficiencies in the 1978 law that was enacted which allowed some individuals to file bankruptcy who may not have belonged in the Bankruptcy process. The advice from Congress to the coalition in 1980 was that there should not be a rush to judge the court results by such recently enacted major piece of legislation. We should consider part of that advice in this situation determining first if it is the Bankruptcy Code that needs to be amended to address the root of the perceived problem. This is especially true since we have no substantial data on how many family farmers that are in need of reorganization are in fact disadvantaged by the Chapter 11 process. Until we have some gauge on the level and parameters of the problem is a bit precipitous to amend the Code.

One problem that any participant in the bankruptcy process must be aware of is the acute shortage of bankruptcy judges. In Iowa, there are two bankruptcy judges for the entire state. The caseload for farmers filing for bankruptcy has increased from seven farmers in 1981 to 387 filing in 1985. In any bankruptcy, time is of the essence. It is imperative that the reorganization or liquidation process commence rapidly, yet often it take months for cases to be heard. Expediting this process would certainly be a great help. ABA would support the legislation increasing the number of bankruptcy judges, especially in areas where the increase in bankruptcies has been so dramatic.

II. INITIAL ASSESSMENT OF NEEDED AMENDMENTS SHOULD THIS LEGISLATION GO FORWARD.

We will actively continue consideration of the bankruptcy problem and these proposed legislative solutions, and we look forward to working with the staffs the two subcommittees, Chairmen East and Grassley, and Ranking Members Heflin and Metzenbaum to reach a solution to the bankruptcy problem.

At least part of our plea for an examination of possible fine tuning of Chapter 11 is due to the number and extent of the changes we perceive to be necessary to make the Chapter 13 approach equitable. Further, in today's highly capitalized agriculture, many family farmer operations exceed the $1.0-$1.5 million in assets. Because family farms vary in size and capital requirements, this number appears arbitrary.

Feasibility Hearing

Another concern relates to the generally poor financial status of farmers by the time they reach the bankruptcy filing stage. Consumer debtors quite often do not consult with their banker before filing a petition in bankruptcy. While a banker may be aware of a slow payment record as an indication of difficulty, many times the first the banker knows of the extent of a consumer's financial distress is the receipt of a notice from the Bankruptcy Court.

This situation is in marked contrast to the typical farmer/banker relationship.

The farmer who finds himself in financial trouble will, more often than not, go to his banker long before filing bankruptcy and attempt to work with the bank and other creditors to resolve the financial difficulties. These negotiations and private work-out plans often extend over years before filing in bankruptcy court, and in many cases exhaust all of the possible ways the farmer could work himself out of difficulty.

Each of these bills provides a lengthy period between the initial filing of the bankruptcy case and any required first payment under a plan of reorganization. If the individual filing bankruptcy is indeed one of those who is in truly dire straits and has no hope of ultimate survival, additional time frames will simply serve to allow the loan collateral to deteriorate further and delay the inevitable. We therefore suggest holding an accelerated confirmation hearing on the plan itself, or a separate "feasibility hearing", to determine whether or not the plan filed by the debtor is realistic. The debtor should be required to provide financial data and projections upon which the plan is based to the concerned parties and the court for assessement. To confirm a Chapter 11 plan, under Section 1129(a)(11) of the existing Bankruptcy Code, there must be a finding that "confirmation of the plan is not likely to be followed by the liquidation or the need for further financial reorganization of the debtor or any successor to the debtor under the plan unless such liquidation or reorganization is proposed in the plan." Such a finding should be required of a family farmer reorganization under Chapter 13, and at a very early date, so that all parties to the plan are protected from a lengthy and fruitless process.

Expeditious Conversion of Chapter 13 Plan to Chapter 7 Liquidation

Consideration also needs to be given to the situation in which a Chapter 13 family farmer bankruptcy plan does not succeed and a rapid conversion to Chapter 7 liquidation is necessary in order to protect the collateral which otherwise might deteriorate. Section 1307(e) of the Bankruptcy Code currently prohibits such conversions. This is especially true in the case of a farmer where often times livestock or perishable products are the collateral for an obligation and the need to move quickly to protect that collateral is paramount. While such a proposal may seem harsh, given the length of time that lenders have stood by their customers in many of these cases, it is only fair for creditors to try and mitigate their losses.

Summary

Mr. Chairman, in summary, our initial reaction to the proposed pieces of legislation is a recognition of the concern in Congress over the financial problems of the family farmer. We, however, are not sure at this point, that amendments of this nature are needed to help solve the problem.

Congress moved with caution and restraint before adopting the 1984 amendments to the Bankruptcy Code. These proposed changes to Chapter 11 or Chapter 13 should be reviewed with the same careful consideration.

Many accolades have been given to farmers potentially using the Chapter 13 approach to farm bankruptcy. Let me briefly address those aspects:

- First, is Chapter 13 less expensive and simpler than Chapter 11? Our task force on bankruptcy could not answer in the affirmative primarily because an attorney must still meet with the debtor to draw up schedules, develop a workable plan and attend all hearings. Further, the debtor and attorney must complete a disclosure statement to analyze the cashflow of the operation.

o Second, is Chapter 13 more flexible? From the farmer's standpoint, the answer appears to be, "Yes". However, a basic premise should be addressed. A family farm is more like a business than an individual with a regular income. Generally, farm income is contingent upon when crops or livestock are sold. Credit advanced to a farmer is not based on income from a third party (wages), but on the basis of the farmer's ability to convert the loan proceeds into a cash crop. When farmers need the protection of the Bankruptcy Code to reorganize creditors, who often have many thousands of dollars invested in the operation, creditors deserve the right to have input into the process.

There may well be ways to work within the existing Chapter 11 framework to provide relief for family farmers that would be less disruptive than the Chapter 13 process. Our initial reaction is that Chapter 11 is more suited to the average family farmer than the Chapter 13 plan.

While in no way diminishing the gravity of the agricultural crisis, we are not sure whether expanding the scope of Chapter 13 bankruptcy to include family farmers is an appropriate solution to the problem. Changing the Bankruptcy Code to assist individual groups may not be the best approach, especially when the root of the problem may not be in the Code itself. Congress may be attempting to address the symptoms of the agricultural problem through the bankruptcy code rather than find the cure by increasing farm income.

It is also our perception that the typical "family farmer" fits better into the Chapter 11 process than into Chapter 13. Chapter 13 is designed and structured for individuals with regular income.

Consumers generally have a steady income stream from a third party in the form of wages. When credit is extended to consumers, the income to fund repayment is separate and distinct from the debt. They are not interdependent. Thus, when a consumer seeks the protection of Chapter 13, he has by definition a source of "regular income" and the only real issue is the rescheduling of the existing debt burden.

This situation contrasts markedly with the Chapter 11 business bankruptcy. In a business environment, a loan is made based on the perceived ability of the obligor to invest the loan proceeds in a business and produce the income for repayment. The management of the business, existing debt burden, future earning prospects, etc. are all critical considerations in deciding whether credit will be extended. Therefore, when the business encounters trouble and needs to reorganize under Chapter 11, creditors are made part of the process of approving the reorganization plan. Since the original credit was extended in order to produce the income, it is only reasonable and equitable that creditors should have input into the reorganization process, which will reform and reshape the original business entity, and which will determine when, if, and how much creditors will be paid.

Chapter 11 provides this through the requirement that a majority of creditors approve the plan of reorganization. This requirement, in essence, forces the parties to come together and negotiate a plan in which a majority of creditors and the debtor can agree.

If, however, there is a decision to proceed with a Chapter 13 approach, additional protections need to be included to safeguard the agricultural lender, and other farm borrowers from excessive losses. There are a number of key issues we are concerned with, including the definition of a "family farmer", feasibility standards for confirming a family farmer plan, and provisions to allow a failing plan to be converted to Chapter 7.

Currently in the Senate version of the Farm Bill, there is a new legislative program available to help reduce interest costs for the farmer who is able to reorganize, and which may help farmers avoid bankruptcy. Our Association supports this new program. In addition, the House/Senate 1986 Budget Reconciliation package includes a provision which would allow forgiveness of farm debt gained through the paper inflation of land values.

Farmers and bankers often work together for years prior to the actual bankruptcy, trying to resolve financial difficulties. It is to the benefit of both to try and work out the situation and restore the farmer to financial health. However, in cases beyond recovery, the needs of the lender and the value of the collateral must also be protected.

The agricultural crisis is real and many farmers are in serious financial trouble. We do not argue with that fact. We are not sure, however, that these bills are the best way to address the problem. We remain very open minded and willing to work with the subcommittee and full committee to help devise an equitable way to address the concerns of the Senators.

On behalf of the American Bankers Association, I would like to thank you for the opportunity to testify and would be pleased to answer any questions.

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510

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November 19, 1985

Mr. Oliver Hansen
c/o American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear ~~Mr. Hansen~~ Ollie:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 6, 1985 concerning farm bankruptices.

Your response by December 2, 1985, to the following questions would be appreciated: *

1. Is it your position that current bankruptcy laws are operating fairly and that therefore Congress should do nothing to provide farmers with greater access to bankruptcy protection?

2. Is it your view that a farm debtor may not reorganize under the bankruptcy law without the consent of secured creditors? Please explain.

3. Do you agree with the assertion that "the indubitable equivalent of cash is cash", or can liens on future crops, livestock or other production items be deemed to be sufficient adequate protection? If not, why not?

4. Please address yourself to In Re American Mariner, 734 F.2d 426 (9th Cir. 1984). Do you agree with the result in this case? Why? Does Congress need to clarify that debtors are not required to provide protection for undersecured claims?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck
CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

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*Unavailable at press time.

Senator **Grassley**. Let me suggest, I can either make you folks stay here another half hour or we can do it this way. That one bell means that I have got 15 minutes to get to the floor to vote. I can stay here for 7 minutes. I would like to stay here and listen to your testimony, John. I want to do that, and then I would like to ask two or three questions orally and then we have got three or four more that we want to submit to you in writing. And when I leave, I can have my staff ask the questions of you, and then we will be able to let everybody go. Otherwise, we are just going to extend it. OK. So you proceed then.

STATEMENT OF JOHN DEAN

Mr. **Dean**. OK. Thank you, Senator, for inviting me. I am here representing the Independent Bankers Association of America. I am from a community of 4,000 people in a predominantly rural area with 12,000 in the whole county. So I am about as rural as you can get.

I am going to summarize this stuff, try to skip what Ollie has had and go on.

I was interested—I have been in a couple of chapter 11's. One we went into as a workout, it was not going to work. The other one we went in at that time, just to tell you what happened, it was on June 6. We loaned a guy $7,000. We took three truck titles for security, a 1970, a 1971 and a 1956 truck. He was supposed to pay it out of that crop that fall. In December he took bankruptcy. We had been getting $80 a month on that. Now, that does not even pay the interest on it. He still owes us $7,000. Now, they say these chapter 11's work and are working. That is about like saying that if you are flying along in a jet and the engine cuts out, it is still flying. It does for a while, but it does not fly very long.

I would also like to read one thing—and it has often been bandied about in the press—that the bankers have been careless in their lending. And I think that is wrong. I submit to you that if they did sometimes go too far, it was not that they cared too little but that they cared too much, and that is what you will find out there in the country. The country banker is a neighbor, he is from a rural community, he is from a rural bank, he very often has relatives that are farmers. He is deeply involved in it. He is going to go a little bit too far rather than not far enough.

The big problem on chapter 13, as I have said in the testimony here, is that it is going to make credit harder for the farmer to get. There may be a few farmers out there whom this will help. But the vast majority of the farmers that maybe are OK are not going to be able to get credit if it is easier and more liberal for them to go into bankruptcy.

In our State right now—2 months ago, an insurance company would make a loan at about 60 percent of the reasonable appraised value of the farm. Now, I talked to them the other day and now they will go 50 percent of the appraised value of the farm. Their appraised value. It will be low. This is because of the moratorium. They do not want that extra risk. They require that the borrower agree not to give a second mortgage on the farm where he has already given a first mortgage. They make him agree not to give a first mortgage on any other land he has. They make him agree not to make any capital expenditures. They make him agree not to lease any major capital expenditures, and they make him give a first lien on the crop. Now, that is making it a little harder to get money.

The biggest problem in this thing is the depressed farm prices as you have pointed out. I think, Senator, you should be congratulated for your work on trying to get that straightened out. We need permanent, some sort of long-term, farm prices that will work. This bankruptcy bill is not a solution that will help us. And as Ollie pointed out—I think it bears repeating—the number of farm banks and the number of banks that have folded in the last—there were three last week. One of them is in Iowa, you know. And those failures are caused by the agricultural lenders not being able to pay their debts. Anything that will make it harder to collect the loans will hurt the banks.

I am a country banker. I do not know anything about the New York banks, and maybe those guys are smart enough to loan in Brazil or Poland or wherever. A foreign loan to me would be Chicago. [Laughter.]

But I think some of those loans are bad, and I think the reason they are bad is because there is no way that those countries can be made to pay. And if you take away the right of the bank or the lender, to force somebody to pay, you are going to have trouble. And I agree with you that the farmer tends to be optimistic. They think, "boy, if I just get one more crop, it is going to work."

I deal in horses a little bit, and there is nothing more optimistic than a man that owns a brood mare. He never commits suicide because next year he is absolutely sure his colt is going to win the Kentucky Derby. He just keeps hoping, keeps hoping. They never win, but he keeps hoping.

I think that the features on chapter 13 are very liberal. I noticed that one of the members said there are no losers in this bill, that the financial institutions in this country will benefit because, instead of getting 10 cents on the dollar, they will be able hopefully to get full payment for those debts that they have. I bet you most lenders will go to that guy and sell out for 50 cents on the dollar, and he can make the 50 cents.

Most financial institutions are loaning, as Ollie says, other people's money. Would you want to loan your widowed mother's $10,000 to some place where there is a big risk of getting it back? Basically that is the money we are loaning. A bank has a very strong fiduciary duty, and I think most bankers realize it. Their first responsibility is to the depositors. They have to be sure that money can be returned under any circumstances. Their second responsibility is to the borrower. They have to be able to service their community, to loan the money. And the third is to their stockholders. If you take care of the first two, the last one will take care of itself.

Now, a lot of people think that when a bank fails, the problem is with the depositors. That is not where the problem arises. It arises, as you know, Senator, because you have heard what happens. You have got a customer out there who maybe owes you $40,000. And maybe after this year's crop, he pays back $30,000 and has enough money to live on. And so you carry some over. Well, when a bank folds, there is no lender to carry that loan over. That money then has to be paid. It is almost more important for a borrower to bank with a sound bank than it is for a depositor. Chapter 13 will reduce credit to the farmer.

Now, I have tried to summarize. It is all in my testimony in a little more detail. But I would be happy to answer any questions.

[Statement follows:]

PREPARED STATEMENT OF JOHN DEAN

Mr. Chairman and members of the Subcommittee, I am John Dean, Vice-Chairman of the Agriculture-Rural America Committee of the Independent Bankers Association of America. I also serve as President of the Glenwood State Bank, Glenwood, Iowa, a community of 4000 people in a predominantly rural county of 12,000 people.

The people in our rural communities which include the merchants, agricultural banks, and farmers - are all in the same boat together. Our agricultural states and, indeed, our entire economy is dependent upon the well - being of this country's farmers.

I would like to emphasis at the outset that the IBAA is deeply concerned about the plight of the thousands of farm families who are currently facing the possibility of bankruptcy. Our bankers are on the "front line", so to speak, of the farm problem. Our neighbors and friends are farmers, and the vast majority of rural bankers, myself included, come from rural backgrounds and have close family members directly engaged in farming.

It has often been said that agricultural bankers have been careless in their lending. I submit to you that if they did sometimes go too far with their borrowers, their error was not that they were "care-less", but that they cared too much.

Mr. Chairman, you have invited us to testify today about the family farmer bankruptcy legislation (HR 2211) and similar legislation which has been introduced in the Senate. This is legislation designed to give the larger farmer easier access to bankruptcy, more specifically, to allow him to qualify under Chapter 13, which previously has focused on the individual wage earner and not the self-employed businessman.

This proposal would give the larger farmer who already has an avenue for reorganizing and restructuring his debts under Chapter 11 an additional route under Chapter 13. It would make it much easier for an unknown - but undoubtedly very large - number of farmers to postpone the repayment of their debts. Although this goal may be beneficial to a few farmers, it could very well do more harm than good to the farm economy as a whole.

The House version (HR 2211) contains the following provisions:

1. Chapter 13, which was designed for the individual wage earner with a limited amount of debt, would be opened up to a new class of debtors classified as "family farmers."

2. To qualify, these debtors would have to have 80 percent of their debt from farming and their total debt would be raised from the current level of $450,000 to one million dollars.

3. Under the "Farmers Chapter 13", contrary to the rest of Chapter 13, debtors would be permitted to "cram down" the mortgage on the farmer's principal residence. This would be permitted even if the residence was not located on the family farm.

4. The farmer's "workout" period under Chapter 13 would be extended from the present 3 years to 10 years.

5. Chapter 11, the bankruptcy vehicle presently used by most farmers, would be changed to allow a farmer 8 months after filing bankruptcy to present a plan to the Court and his creditors, rather than the present 4 months.

The IBAA must oppose HR 2211 and similar proposals for several reasons.

1. This legislation merely shifts the farm debt burden from insolvent farmers to farm lenders and suppliers. It does not deal with any of the underlying problems facing the family farmer, particularly the problem of depressed farm prices. Instead, it simply confers a special status on a particular group of farm-related debtors and shifts the losses to the small businessmen, agricultural suppliers, commercial banks, thrifts, and the farm credit system.

   The banks have limited capacity to absorb losses that are shifted to them. There have been more bank failures this year - 98 as of November 2 - than in any single year since the Great Depression. Roughly half of these are agricultural banks.

   Banks do not loan their own money to farmers; they loan other people's money. Banks generally agree to pay their depositors upon demand. Any legislation that interferes with the banks' ability to collect their loans directly affects the banks' ability to pay their depositors. Fairness would dictate that if Congress passes any new laws to allow borrowers to slow down their payments to their banks, a like provision should allow the banks to slow down their payments to their depositors. A good banker should look at the money he is loaning as you would look after your widowed Mother's money if you were loaning it for her. In fact, that is often whose money we are loaning.

It is impossible to estimate the effect which increased numbers of farm bankruptcy failures could have on commercial banks, their depositors, and their borrowers. We do know, however, that bank examiners classify loans that are in bankruptcy as "doubtful" because experience has shown that the chance of recovery is considered extremely uncertain. This, in turn, affects the capital ratio of a bank and its ability to loan to its other agricultural borrowers who may be solvent but somewhat weak.

There is good reason for this adverse classification of loans in bankruptcy, since creditors rarely get anything close to "full payment" under Chapter 13 regardless of whether it takes 3 years or 10 years. The ones I have seen have paid out a smaller percentage after bankruptcy reorganization than if they had liquidated immediately.

2. This legislation will make it more difficult for many farmers to obtain additional credit. If Chapter 13 is made available to farmers on a broader basis and if the creditors' veto rights are more limited, agricultural suppliers and agricultural banks will have to carefully re-evaluate their

> lending policies because it will become more risky for them to stick with or extend new credit to those farmers who may be candidates for Chapter 13 next year. Bankers, for the most part, appreciate the fiduciary responsibility they have to their depositors and investors, who depend upon the safety and soundness of our banking system. They will simply cut back on their lending to marginal farmers.

This legislation sets a bad precedent by establishing a special status for a particular set of debtors. Is it really proper and valuable to try to distinguish in this regard between the family farmer and the Main Street merchants in farm areas - such as feed, machinery, or fertilizer dealers - who are also in dire financial straits due to the depressed farm economy? Under these proposals, Chapter 13 could be used to force creditors who hold secured mortgages on real estate to accept modifications in the terms agreed upon when the mortgage was made on the residence of the debtor, even if this residence is not on the farm. To what extent should we allow agreements to be changed by law after they are made?

Instead of making precipitous changes in the Bankruptcy Code at this time, we would encourage Congress to strengthen farm prices and income and to adopt measures which can assist both farmers and their lenders in working their way out of the severe difficulties now being experienced in agriculture.

We believe that the first priority should be on the general farm bill now pending in Congress. That legislation should maintain the commodity price and income supports at the maximum possible level, for the full four years, 1986-1989. Only if the basic financial and cash flow position of farmers is improved will real progress be made in coping with farmers' indebtedness problems.

Attached to this statement is a copy of our letter sent to all members of the Senate recommending that, at a minimum, the farm income supports (target prices) must be maintained at existing levels for the next four years.

We also believe that farmers should have the right to decide whether they want to use mandatory production controls combined with higher price support loan levels during this period of depressed prices and over-production.

Mr. Chairman, we want to work with the Congress on steps to improve conditions in the farm economy, with equitable treatment for all of those who are trying to work their way out of the present difficulties.

This concludes my prepared statement, and I would be pleased to respond to any questions.

Personalized to all members of the U.S. Senate

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

B. F. Backlund
President

Charles T. Doyle
President-Elect

Thomas H. Olson
Vice President

Charles L. VanArsdale
Treasurer

October 24, 1985

Honorable Robert Dole
United States Senate
141 Hart Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Dole:

On behalf of the Independent Bankers Association of America, I strongly urge you to support at least those levels of farm income support (target prices) which have been approved by the Committee on Agriculture in S. 1714, for the full four-year period 1986-1989, and to oppose Senate floor amendments which would reduce those levels for any of the four years.

Even with the farm income supports of $3.03 for corn and the other existing levels which are contained in S. 1714, the financial position of many farmers will continue to deteriorate unless export demand for farm commodities recovers much sooner than anticipated. At a minimum, the general farm bill needs to assure the present levels of farm income support for the full four years--in order to provide a measure of critical multi-year stability to farmers' cash returns and to farmland values which are directly related to those production returns.

Such minimum levels of target prices, for the four years, can provide some hope that many of our financially-stressed farm borrowers will have time to work their way out of their present difficulties, and that more and more of our farm borrowers will not slip into an insolvent position before export markets recover. Farm lenders have an important stake in these farm income support policies, since servicing and repayment ability for both farm production and farm real estate debt is directly dependent upon the adequacy of farmers' returns from their operations. Providing some stability for farmers' returns on a multi-year basis is quite important, in order that projections can be made of their cash flow situation and thus their capacity for incurring and managing debt.

We appreciate your concern about the depressed situation in agriculture, and we hope that these recommendations are helpful.

Sincerely,

Bud Gerhart

Bud Gerhart, Chairman
Agriculture-Rural Committee

Senator **Grassley**. Before my staff asks questions, and then he will adjourn the meeting, there are two things I need to say in closing.

First, unrelated to this hearing, I would like to have both of you get in touch with Kristin Gord, of my staff, and she is here in the audience. I want you to put some thought into Iona's moratorium on foreclosures. You know when our Governor Terry Branstad announced the moratorium, there were a lot of things said about what was going to happen. And I am well aware of those statements.

Now, 1 month down the road, if you can tell us things that have definitely happened as a result, with respect to changes in lending practices that affect the family farmer, it would be very beneficial to me. If I could have that information from both of you, or anybody else that you think is in a better position to give it to me, then I'd be grateful.

Second, as a result of this hearing, I have a meeting scheduled afterward with some of the witnesses and I would like to say that my staff will see to it that we also get together.

So I will leave now. Thank you all for coming.

Mr. **Gerdano**. Mr. Dean and Mr. Hansen, I am Sam Gerdano and I am a counsel to the subcommittee. I just have a couple of very brief questions that hopefully we can deal with in a short period of time, and then we will submit questions in writing.

A short time ago, bankers groups urged Congress to encourage consumer debtors to file under chapter 13 rather than simply to liquidate under chapter 7. That was 2 or 3 years ago. It was part of the consumer bankruptcy amendments that took quite awhile to get through the Congress.

Why do you all not feel the same way with respect to farm debtors? In other words, encouraging them to use the chapter 13 procedures.

Mr. **Dean**. Why did they encourage—I do not understand your question, I guess. I do not understand you. Why did they encourage consumers to file under chapter 13?

Mr. **Gerdano**. Right. Rather than to simply liquidate under chapter 7.

Mr. **Dean**. I would presume, and I do not know anything about this, I would presume because they thought the payout would be better.

Now, I say that under chapter 11 and under a 10-year payout—you know, the Second World War only lasted 5 years. Under a 10-year payout, or under the chapter 11 I have seen, the liquidation has always been less than immediate liquidation.

Is that right, Ollie?

Mr. **Hansen**. That certainly was our personal experience.

Mr. **Dean**. That the creditors get more now than they will later.

Now, if there is a snowball in hell's chance that it will work the other way, I think the banker will go along with it.

Mr. **Hansen**. I might add to that, John, if there is a chance in hell that it is going to work, we are not going to go into bankruptcy.

Mr. **Dean**. Yes.

Mr. Hansen. He was a banker in the town of Bloomfield, IA, where the private bank was closed sometime back. He was in the other bank that survived, and after losing 27 pounds from one winter of worrying, he said, "Ollie, if there is any way to avoid a bankruptcy, do it at all costs."

We have had one farm bankruptcy in our bank. Our legal fee at the last accounting was over $12,000. We still have another bill coming. The bank that I am a director of had $16,000 expense last year, and this year up to date, there will be more. It is only a $20 million bank; $8,000 last year, about $3,000 or $4,000 the year before. Within the last 3 years, we have had $30,000 legal expense on bankruptcies.

If there is a viable situation to be agreed to, I am not going to say all bankers are going to use it, but I am going to say that a vast majority of them are certainly going to try it, the same as we did. In one case, we took tracts of ground back from two people on an amicable basis.

Mr. Dean. And we had a chapter 11— other than the one I told you about—where we were not in it. It came in under a reorganization with a super priority lien you are familiar with. And so the guy was on a family farm, we had banked his grandfather, we had banked his father, we had banked this boy—he was not a boy—so we said we are going to go with you and see if maybe you can hold it together. We did not know that that was the year that the Missouri River was going to come out of its banks and they were going to get no crop. And we lost.

But I think, as Ollie said, the banker, if there is just a glimmer, the bank is going to go with it. But if there is going to be a lot of possibilities out there of bankruptcy which will increase your loss, basically what will happen is the only people who will get loans will be those who do not need them.

Mr. Gerdano. If Congresss were to choose the chapter 13 alternative, as suggested in the House bill, for example, I presume there would need to be some changes in banking regulations in the area of writing off loans that are in bankruptcy.

Would that be correct? Otherwise, there would be a tremendous amount of——

Mr. Dean. I covered that in my statement that the examiners generally classify loans that are in bankruptcy, and the reason they do is because experience has shown them that very seldom do they pay out.

Mr. Gerdano. Right.

But if bank regulators, and they are going to appear at our second hearing on this issue, if they agreed to change their rules, would you have less of an objection to the liberalized chapter 13?

Mr. Dean. No. Because I think that would be Chinese bookkeeping. You would be putting a value there that really was not there. And I think that is unsound.

Mr. Hansen. One of the basic facts that I think is misunderstood so often is that bankers are supposed to make a profit, and the better part of those profits are supposed to go under our capital structure. If we do not maintain the proper capital structure, our regulators are on our backs, and rightly so.

I was a regulator for 2 years. I got on people's backs. And if we cannot work things out, and we have to go out and raise money for capital today, bank stock in rural communities is not easy to sell. Bank loans from correspondent banks are not easy to get for agricultural banks. And the rural banker is going to be put in a very precarious position between his shareholders, his depositors, and his regulators, and everyone else that is involved.

Mr. **Dean**. And then who is going to lend to the farmer?

Mr. **Hansen**. Right.

Mr. **Dean**. A bank closed in Iowa last week, a good bank in a good territory, a $20 million bank, which is not very big by Washington standards, but by Iowa standards it is a pretty good sized bank. It sold for $10,000.

Mr. **Gerdano**. Well, we appreciate your comments. We will excuse this panel and remind you that we will submit some questions in writing shortly.

[Information follows:]

United States Senate

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WASHINGTON, DC 20510

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November 19, 1985

Mr. John Dean
c/o Independent Bankers Association
1625 Massachusetts Avenue, N.W.
Suite 202
Washington, D.C. 20036

Dear Mr. Dean:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 6, 1985 concerning farm bankruptices.

Your response by December 2, 1985, to the following questions would be appreciated:

1. Is it your position that current bankruptcy laws are operating fairly and that therefore Congress should do nothing to provide farmers with greater access to bankruptcy protection?

2. Is it your view that a farm debtor may not reorganize under the bankruptcy law without the consent of secured creditors? Please explain.

3. Do you agree with the assertion that "the indubitable equivalent of cash is cash", or can liens on future crops, livestock or other production items be deemed to be sufficient adequate protection? If not, why not?

4. Please address yourself to In Re American Mariner, 734 F.2d 426 (9th Cir. 1984). Do you agree with the result in this case? Why? Does Congress need to clarify that debtors are not required to provide protection for undersecured claims?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

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December 3, 1985

Sen. Charles E. Grassley, Chairman
Subcommittee on Administrative Practice
and Procedure
Committee on the Judiciary
U.S. Senate
Washington, D.C. 20510

Dear Senator Grassley:

I am writing in reference to your letter of November 19, 1985, requesting responses to certain questions arising from my testimony before the recent joint subcommittee hearings on farm bankruptcies.

On behalf of the Independent Bankers Association of America, I would respond as follows:

Question 1 - Is it your position that current bankruptcy laws are operating fairly and that therefore Congress should do nothing to provide farmers with greater access to bankruptcy protection?

Response - The IBAA is not really in a position to know whether the federal bankruptcy laws are "operating fairly" as to both debtors and creditors in farmer bankruptcies throughout the country. From our experience as creditors, the bankruptcy laws are heavily weighted in favor of debtors. Insufficient data has been collected to say that farmers do or do not have adequate access to the protection of the bankruptcy laws.

Your hearings produced somewhat conflicting and confusing testimony on whether Chapter 11, in particular, had proved effective in meeting farmers' needs. The IBAA would suggest that the Judiciary Committee request the General Accounting Office (GAO) and/or the Justice Department to gather empirical data on how Chapters 7, 11, & 13 currently function for farmers and whether farmers, as a group, are being denied adequate access to bankruptcy. In particular, the GAO should determine the percent of creditor recoveries under each Chapter. This information is determinable and could prove extremely usefull to the Committee.

Question 2 - Is it your view that a farm debtor may not reorganize under the bankruptcy laws without the consent of secured creditors? Please explain.

Response - Farm debtors may reorganize without the consent of secured creditors. Although Chapter 11 is intended to provide a mechanism for reorganizations worked out in cooperation between a debtor and his secured creditors, such agreement is not necessary. There are many reported cases in which some creditors have objected strenuously to a debtor's Chapter 11 plan, only to have it confirmed by the court. The legal standard applied by the courts is whether a proposed plan is "fair and equitable" and whether the creditor has received adequate protection.

Question 3 - Do you agree with the assertion that the "indubitable equivalent of cash is cash", or can liens on future crops, livestock or other production items be deemed to be sufficient adequate protection? If not, why not?

Response - The legal interpretation of the phrase "indubitable equivalent" contained in 11 USC 361(3) has been subject to varying judicial interpretations. I do not think the hard-line position that only cash can serve as the "indubitable equivalent" of a cash debt is the prevailing one. In fact, the Mariner case cited in your letter held that the monthly payment of interest demanded by Crocker National Bank as adequate protection was only one way to provide the bank with the indubitable equivalent of its security interest. The court stated:

> We agree that this is one method of providing adequate protection but by no means the only method available to the debtor. Consistent with the policies behind Sections 361 and 362, the debtor should be permitted maximum flexibility in structuring a proposal for adequate protection. The result, however, should as nearly as possible under the circumstances of the case provide the creditor with the value of his bargained for rights.

(In re American Mariner Industries, Inc., 734 F.2d 426, 435 (9th Cir. 1984).

Even the Ninth Circuit has not gone so far as to suggest that only cash can serve as adequate protection. To our knowledge, most courts have held that cash or "near cash" which is reasonably certain can serve as the "indubitable equivalent" of a creditor's security interest.

Question 4 - Please address yourself to In re American Mariner, 734 F.2d 426 (9th Cir. 1984). Do you agree with the result in this case? Why? Does Congress need to clarify that debtors are not required to provide protection for undersecured claims?

Response - The Mariner case held that an undersecured creditor who had been stopped from exercising his statutory rights to secure repayment from a debtor in Chapter 11 bankruptcy was entitled, under the concept of "adequate protection", to receive periodic interest payments on the debt in order to compensate the creditor for any possible diminution in the value of his interest in the collateral. We support this decision since it strikes an appropriate balance between the right of a debtor to secure a "breathing space" from his creditors through the automatic stay and the right of a creditor to receive compensation for being unable to demand prompt payment or to foreclose and take possession of the collateral. Congress does not need to take further action on this issue.

Please let me know if I can be of any further assistance on the important issue of farmer bankruptcy.

Sincerely,

John C. Dean

John C. Dean,
Vice-Chairman
Agriculture-Rural
America Committee

Mr. Gerdano. Thank you very much.

At this point, I would like to enter into the record, as if read, a brief closing statement by Senator Grassley. I will not read it.

[Statement follows:]

CONCLUDING STATEMENT BY SENATOR CHARLES E. GRASSLEY
OCTOBER 24, 1985

I WANT TO THANK ALL OF THE WITNESSES WHO HAVE APPEARED THIS MORNING. AGAIN, LET ME APOLOGIZE FOR HAVING TO MAKE THE HEARING SOMEWHAT SHORTER THAN I MIGHT HAVE OTHERWISE LIKED. I WANT TO REMIND THE WITNESSES THAT WE WILL BE SUBMITTING WRITTEN QUESTIONS FROM THOSE MEMBERS OF THE TWO SUBCOMMITTEES THAT WISH TO SUBMIT QUESTIONS. WE WOULD APPRECIATE PROMPT RESPONSES.

I BELIEVE WE'RE ON OUR WAY TO DEVELOPING A VERY GOOD RECORD ABOUT HOW TO TREAT FARMERS WHEN THEY ATTEMPT TO REORGANIZE THEIR DEBTS. I THINK IT'S CLEAR THAT SOMETHING NEEDS TO BE DONE IN TERMS OF STREAMLINING PROCEDURES TO MAKE CHAPTER 11 BANKRUPTCIES SIMPLER AND LESS EXPENSIVE. I WILL CONTINUE TO LOOK TO THOSE PROPONENTS OF BOTH THE STATUS QUO AND OF CHANGE IN THE BANKRUPTCY CODE TO JUSTIFY THEIR POSITIONS.

UNTIL WE CONTINUE WITH THIS ISSUE ON NOVEMBER 12 THEN, THE SUBCOMMITTEE WILL STAND ADJOURNED.

Mr. GERDANO. Until we continue with this issue on November 12, the subcommittee will be adjourned.

[Whereupon, at 1:40 p.m., the subcommittees adjourned, subject to the call of the Chair.]

FARM BANKRUPTCY

TUESDAY, NOVEMBER 12, 1985

U.S. SENATE, SUBCOMMITTEE ON COURTS,
AND SUBCOMMITTEES ON ADMINISTRATIVE
PRACTICE AND PROCEDURE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittees met at 10 a.m., in room SD-226, Dirksen Senate Office Building, Hon. John P. East presiding.

Also present: Senators Grassley and Specter.

Staff present: David E. Anderson, chief counsel and staff director of Subcommittee on Courts, and Samuel Gerdano, counsel, Subcommittee on Administrative Practice and Procedure.

OPENING STATEMENT OF HON. JOHN P. EAST, A U.S. SENATOR FROM THE STATE OF NORTH CAROLINA, CHAIRMAN, SUBCOMMITTEE ON COURTS

Senator EAST. I would like to please call to order this second joint hearing of the Subcommittee on Administrative Practice and Procedure and the Courts Subcommittee.

We previously held a hearing on the issue of the farm economic crisis and the related question of bankruptcy. To review briefly the bidding here, if I might, at our last hearing we were noting the great economic crisis on the American farm nationwide. We were noting that the facts and figures would indeed even suggest that we are in a period of depression on the American farm. We had noted that net farm income has declined by 27 percent in the previous 4-year period. Land values have declined 26 percent between 1981 and 1984, and today approximately 30 percent of the American farmers are considered to be in genuine financial distress. It is commonplace to say we can take judicial notice of the fact that the farm economy is a vital component of our whole economy. It is a vital part of the whole American experience, truly an American way of life.

In our previous session, Senator Grassley, my distinguished colleague from Iowa, and I both pointed out, and I think properly so, that reforming the Bankruptcy Code will not solve all the farm problems. Indeed, bankruptcy is only a portion of the larger problem; but it is not an insignificant element. In the hope that prudent reform of the bankruptcy laws could assist the family farmer and others involved in agriculture to survive the current slump, Senator Grassley and I have convened this joint committee hearing.

I had noted last time that I think it is important in these hearings to keep in mind, not only the very real and genuine problems of the debtor but, of course, those of the creditor in the farm community. He, too, is under a great deal of stress and strain today. If, in reforming the bankruptcy laws, we put undue burdens upon farm lenders, pushing them into deeper financial straits, we would not really be solving the problem. We would simply be exacerbating it. The challenge which we face is to develop a healthy and balanced approach, one that will protect the rights of the debtor, and that will also allow the debtor a greater flexibility in trying to get out of his financial bind.

Those are some of the major matters we touched upon at our last hearings and which were raised by some excellent witnesses in their testimony. This morning, we likewise have an excellent list of witnesses. I wish to thank them all as chairman of the Subcommittee on Courts, for their coming and being a part of this effort.

As Senator Grassley and I noted last time, we do like to move along as expeditiously as possible, and would greatly appreciate a brief summary of the witnesses' testimony. In keeping with my own admonition here, I shall proceed to the witnesses.

We are fortunate this morning, and I hope others would join me in my exhilaration to have two witnesses from North Carolina.

If Hon. Thomas M. Moore and Hon. A. Thomas Small will please come forward here, we will begin our proceedings. These two gentlemen are bankruptcy judges from my fair State, and I am honored and delighted to have them here this morning and wish to thank them for coming and participating in this hearing.

I did not know if Senator Grassley would like to make a comment or two in opening, and then we will move to our witnesses.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. Thank you, Mr. Chairman.

I would emphasize the statistics showing the declining economic situation in rural America. Those national percentages that you gave are even worse for the grain-producing regions of the upper Midwest. For instance, the national average of a 28-percent decline in land value would be 49 percent at this point in Iowa and Nebraska. But I do appreciate your bringing those statistics out because I think that where we do have these dramatic declines, the use of the bankruptcy laws to reorganize becomes especially important. In this period of flux, our Congress is trying to work out support to the Farm Credit System as well as craft basic farm legislation. At the same time, through the budget process, Congress is trying to do something about interest rates and the value of the dollar. We are in an interim period of time. Therefore the safety nets in our statutes are very important and need to work the best way they can. These specific hearings have zeroed in on how the bankruptcy laws do not work from either the farm debtor or their creditor's standpoint. From the farmer's standpoint when creditors will not consent to a reamortization of debt, the ability to confirm a deferred payment plan is lessened. For lenders, the chances of a farm debtor succeeding in a chapter 11 reorganization are currently remote. The temporary breathing space offered by chapter 11 is often to no avail in today's farm economy. In the interim, valuable collateral deteriorates.

Again, I would like to thank the chairman for holding these 2 days of hearings. One thing I think we can all appreciate at this point is how complicated this area of the law is. Relatively minor changes in definition or in timing have potentially major and harmful effects on related components of our rural communities. We have to be cognizant of the impact upon the agribusiness community, in small towns throughout rural America. I am looking forward to working beyond today's hearings with members of the subcommittees and our assembled experts to try to achieve a consensus that provides some reasonable measure of relief to farmers.

So, Mr. Chairman, I look forward to this last day of hearings on this subject, and then getting down to work, trying to draft the legislation necessary to deal with these problems while making use of the expert testimony that we are receiving these 2 days.

Senator **East**. Thank you, Senator.

Judge Moore.

STATEMENTS OF A PANEL CONSISTING OF HON. THOMAS M. MOORE AND HON. A. THOMAS SMALL, BANKRUPTCY JUDGES, EASTERN DISTRICT OF NORTH CAROLINA

Judge **Moore**. Mr. Chairman, thank you for the opportunity to appear before this joint hearing. I have already submitted a prepared written statement, but I would like to make just a few comments on the subject of family farm bankruptcies in addition to my written statement.

As you indicated or noted, the family farmer in eastern North Carolina is currently experiencing difficulties. The Bankruptcy Code of 1978, as amended, does not provide the family farmer an effective means of relief. If the Congress decides to provide the farmer with effective relief through the Bankruptcy Code, it would be my recommendation that it do so in the context of a chapter 11 rather than a chapter 13. A separate subchapter to chapter 11, as proposed in S. 705, would seem to be quite appropriate. Such legislation, if enacted, should modify the requirements for adequate protection.

When a debtor files a case under chapter 11 or chapter 13, an automatic stay comes in to effect which prevents a creditor from taking further action to enforce or collect his obligations from the debtor. One of the initial steps taken is to file a motion to lift the automatic stay, and the stay then is lifted unless the debtor provides a creditor with adequate protection. Adequate protection, or the concept of adequate protection, requires the debtor to make periodic payments to the secured creditor for the decline in the value of the property, and also in the fourth circuit, as a result of the case of *Grundy National Bank,* it requires the payment of lost opportunity cost to the secured creditor if the secured creditor is undersecured. The requirement for paying adequate protection in the initial stages of a farmer reorganization proceeding is usually out of the question.

In most cases, a farmer-debtor can bearly pay his filing fee for filing the petition. And in many instances he is unable to pay a retainer fee to counsel. He has no operating funds, either to pay for the decline in the value of the real property and the equipment which he intends to use for the next year or to pay for lost opportunity costs which is to compensate the secured creditor for the loss of the interest on the loans to the debtor.

So, I think we need to initially realize that the farmer really has no chance to propose a reorganization unless we deal with this adequate protection. The motion to lift stay is filed within the first 30 days after the debtor files his petition. The code requires us to hear that motion within 30 days after it is filed. So, usually, within 60 or 90 days, if adequate protection cannot be provided, the debtor's principal assets are subject to foreclosure in the State court because the stay is lifted.

I think it is essential that we face and deal with that problem if you want to provide the farmer-debtor with some effective relief.

Next, I think that we ought to encourage the farmer to properly liquidate, through the bankruptcy court, any of the assets that he realizes he is financially unable to keep and pay for out of the reorganization or those assets which are clearly not necessary to a reorganization. The secured creditor wants the assets liquidated that are not necessary to the reorganization. And if the farmer will make that hard decision initially and say I want to keep this 100 acres and my dwelling, and I will release the other property, and I will release this equipment that I do not really need and get along without it, it goes a long way toward obtaining creditor cooperation when the time comes to vote upon a plan for reorganization.

Also, I think some effective means for the farmer-debtor to dispose of this property, and there are provisions now for the sale of the property, but there is some question as to whether or not this property can be sold over the creditor's objection unless there is a genuine dispute, or unless there is some equity present in the collateral. That is another area of the law that should be addressed.

Certainly I feel like the absolute priority rule is going to have to be drastically modified or completely eliminated in order to provide the farmer with some effective means of reorganization. That rule is one which requires you to satisfy in full the preceding class in the priority list before the debtor can retain any property. In many instances, the farmer-debtor wishes to retain his exempt property, and there is some question as to whether that priority rule would prevent him from doing so without paying the unsecured creditors in full.

I think, in addition to those three things, that perhaps we need to think in terms of what is a reasonable length of time for the farmer-debtor to prepare and file a plan, one that has some chances of success. So, in addressing this problem that you are now faced with, you should address and consider carefully these four areas where the problems seem to arise.

Thank you, Senator.

Senator East. Thank you, Judge Moore.

Judge Small.

STATEMENT OF HON. A. THOMAS SMALL

Judge Small. Mr. Chairman, Senate bills 1342, 1516, and House bill 2211 would lower the threshold for chapter 13 debtors so that family farmers could reorganize their financial affairs in chapter 13. Implicit in this, I think, is a recognition that chapter 11 really doesn't work for family farmers. After all, chapter 11 is designed to meet the needs of corporations, not individuals. Chapter 11 is burdensome, it is time consuming, it is expensive, and chapter 11 contains standards for confirmation which the debtor family farmer frequently cannot meet.

In the typical chapter 11 farm case that we see, there is one major lender and that lender has a security interest on the house, the farmland, the crops, the farm equipment, the livestock, virtually everything except the family dog. That creditor would have then a secured claim to the extent of the value of the collateral. To the extent that the collateral is less than the amount of the loan, that creditor has an unsecured claim.

Well, you have already heard testimony about the declining value of the farm, that is certainly true in our jurisdiction. The effect of that is to give that secured creditor a large unsecured claim. As a result, he has got an inordinate amount of power over that chapter 11 case. One no vote by that creditor causes that plan to completely collapse.

Now, in chapter 11, a debtor can obtain confirmation over the objection of unsecured creditors, but to do that, that debtor has to pay all his creditors in full or that debtor is not allowed to retain any property.

Well, usually a farmer would not be in bankruptcy if he were able to pay his creditors in full. So really the condition is an impossible condition to meet. Chapter 13 would eliminate a lot of these problems, and chapter 13 is certainly a laudable section of the bankruptcy law. It benefits creditors and debtors.

Judge Moore and I encourage people to use chapter 13, and I am pleased to say that in the Eastern District of North Carolina, 52 percent of all cases are filed under chapter 13. Realistically, though, chapter 13 is not going to work for the family farmer. It was designed primarily for wage earners and small businesses with regular income. It is not designed for the family farmer, and it is not suited for the family farmer.

First of all, chapter 13 does not deal with the problem that Judge Moore mentioned, the requirement that the debtor has to pay lost opportunity costs. Judge Moore has already discussed that but I do not think you can overemphasize the detriment that this problem has to the family farmer.

Another problem with chapter 13 is the requirement that the plan be filed with the bankruptcy petition. Now, chapter 11 debtors have 120 days to file their plan. The bills before this committee would change that to 240 days in chapter 11, but it does not change that requirement with respect to chapter 13 debtors. So chapter 13 debtors would immediately have to file their plan upon filing their petition. Our experience has been that farmers in chapter 11 need 120 days, and then they come in and ask for a longer period of time. It is simply unreasonable to have them file the plan when they file their petition. The bills before this committee would solve some of the farmers' problems in chapter 13. For example, they allow the farmer to rearrange financing of his mortgage. They would allow the court in its discretion to extend the time that payments are to commence in chapter 13 and they would extend the length of the plan to possibly 10 years as opposed to 5 years as provided under the present law.

Judge Moore and I do not think that 10 years is really long enough to reorganize debtors' affairs. There is no limitation in chapter 11 as to the extent of the plan, and to that extent chapter 11 is broader than chapter 13.

There are at least two other areas in which chapter 13 is more limiting than chapter 11. In chapter 13, the debtor may be compelled to pay all of his visible income into the plan for a period of 3 years. There is no such requirement in chapter 11. Also in chapter 13, unsecured creditors can modify that debtor's plan based on changed circumstances. That requirement is also one that is not present in chapter 11.

Well, if there are problems in chapter 13 for the family farmer, there are even more serious problems for the farm creditors in chapter 13. In many of our chapter 11 cases, the farmer comes in and wants to liquidate property that is not being used. Chapter 13 is simply not a good chapter in which to liquidate property. There is just not the scrutiny that you need. In many of these farm cases we see sales to neighbors, relatives, and friends, and it really needs to be controlled.

There is always a trustee in chapter 13, but the sales are controlled in chapter 13 by the debtor, not the trustee. A potentially more serious problem in chapter 13 for creditors relates to the broad discharge sections in chapter 13.

We have both had cases where the farmers have used the lender's collateral for purposes other than paying back the lender. That activity would result in a nondischargeable debt in chapter 7 or chapter 11, but that debt would be discharged in chapter 13 and, frankly, I think that is unfair to your creditors.

Another problem for creditors in chapter 13 is the right that the debtor has to automatically dismiss his case. If, for any reason, the debtor wants to get out of chapter 13, that case can be dismissed. I do not believe the debtor should be able to control whether that case should be dismissed. If the debtor has had a fair opportunity to have a plan confirmed, then liquidation is not unreasonable either in chapter 7 or in liquidation plans under chapter 11.

In conclusion, I would say there are problems in chapter 11 for family farmers. They can be improved somewhat by moving the family farmer to chapter 13 but, really, chapter 13 is not adequate for the family farmers' problems. In fact, it may cause more problems than it solves. The big problem is the need to—the requirement to provide adequate protection for lost opportunity costs. And somehow that problem has to be dealt with.

I would be happy to answer any questions.

[Statements follow:]

PREPARED STATEMENT OF A. THOMAS SMALL

I am A. Thomas Small, the junior bankruptcy judge for the Eastern District of North Carolina. I have been a bankruptcy judge since 1982, and have been involved in bankruptcy matters since 1969. Judge Moore has mentioned that we have identified four areas of the bankruptcy law in which farmers encounter difficulty. Judge Moore discussed the obstacles created by the need to adequately protect lost opportunity costs and the potential inability to sell property free of liens. In examining the farmer's problems with Chapter 11, the farmer's relationship to Chapter 13, and the rights of farm creditors in Chapter 13, I will discuss the farmer's need for a reasonable length of time to file a plan and the farmer's need for a method of confirming a plan over the objection of the class of unsecured creditors.

The Farmer and Chapter 11

Currently individuals in need of financial rehabilitation may proceed under either Chapter 11 or Chapter 13 of the Bankruptcy Code. Most farmers, however, have too much debt to qualify as debtors under Chapter 13 (unsecured debts must be less than one hundred thousand dollars, secured debts must be less than three hundred fifty thousand—§ 109(e)) and thus are limited to rehabilitative relief under Chapter 11. Unfortunately, many farmers have found Chapter 11 needlessly complicated, unduly time-consuming, inordinately expensive, and, in some cases, unworkable.

Part of the problem is that Chapter 11, which replaced Chapters X, XI, and XII of the Bankruptcy Act of 1898, is better suited for corporate reorganization than for the rehabilitation of individuals.

In Chapter 11, each class of impaired creditors is entitled to vote on a proposed plan. Acceptance by a class requires the acceptance by at least two-thirds in amount of creditor claims and one-half in number of class members voting

(§ 1126(c)). This high voting requirement means that a single secured creditor with a large deficiency (unsecured) claim may, by casting a ballot rejecting the plan, prevent the debtor from obtaining the acceptances of the unsecured class.

Notwithstanding the rejection of a class, a Chapter 11 plan may be confirmed by use of what is known as the "cramdown." (§ 1129(b)). But if a plan is confirmed without the acceptance of a class of impaired unsecured creditors, the debtor may not receive or retain "any property" under the plan unless that class is paid in full (§ 1129(b)(2)(B)(ii)). This provision is a carryover of the "fair and equitable" absolute priority rules of former Chapter X (Corporate Reorganization), which, among other things, prevented stockholders from retaining stock over the objection of unsecured creditors that were not being paid in full (Bankruptcy Act § 221(2); 11 U.S.C. § 621, repealed October 1, 1979). Such a rule makes sense in a corporate case, but, read literally, § 1129(b)(2)(B)(ii) has the effect of denying the individual debtor the use of the cramdown if the debtor is retaining any property at all, including exempt property or property which is fully encumbered. In re Tomlin, 22 B.R. 876 (Bankr. M.D. AL 1982); In re Fursman Ranch, 38 B.R. 907 (Bankr. W.D. MO 1984). Consequently, this provision thwarts the prime purpose of Chapter 11—to make possible the reorganization of the debtor's financial affairs in such a way that he may meet his obligations and continue in operation.

Until 1979, the necessary relief was previously available under former Chapter XII, which provided that an individual farmer could use the cramdown and obtain confirmation of a plan over the objection of creditors while retaining property. In 1952, Chapter XII was amended to remove the "fair and equitable" rule and to make it clear that confirmation should not be refused "solely because the interest of a debtor will be preserved under the arrangement." (Bankruptcy Act § 472, 11 U.S.C. § 872, repealed October 1, 1979). This Chapter

XII provision, however, was not included in Chapter 11, and as a result, some farmers have had difficulty achieving confirmation of plans over creditors' objections. [For a good discussion of this problem, see Anderson and Rainach, Farmer Reorganizations Under the New Bankruptcy Code, 28 Loyola Law Review 439 (1982).]

When a farmer is unsuccessful in having a plan confirmed, a creditor may file a plan calling for the liquidation of the debtor's property (§ 1121(c)). Matter of Button Hook Cattle Co. Inc., 747 F.2d 438 (8th Cir. 1984); In re Jasik, 727 F.2d 1379, reh'g. denied, 731 F.2d 888 (5th Cir. 1984). Three sections of the Bankruptcy Code (§§ 303(a), 1112(c) and 1307(e)) ensure that a farmer may not be subjected to involuntary Chapter 7 liquidation; the intent clearly is to protect such distressed farmers, but a creditor's plan of liquidation is identical in effect.

As a result of these restrictions of Chapter 11, then, a farmer may be seriously handicapped in the pursuit of rehabilitation under Chapter 11.

The Farmer and Chapter 13

The solution to the farmer's problems provided by S. 1342 is to give the family farmer access to Chapter 13. This approach will solve some of the farmer's Chapter 11 difficulties, but it does not address the adequate protection and sale free of lien problems previously discussed. Chapter 13 may also introduce new problems for farmers and may give the farmers an unfair advantage with respect to farm lenders.

Granted, there are marked benefits under S. 1342. First, Chapter 13 is certainly less cumbersome and less expensive than Chapter 11. There is no disclosure statement to file, no creditors' committee with which to deal, and no drawn-out confirmation process. Second, unsecured creditors do not vote in Chapter 13 cases, though to be confirmable, the plan must meet the requirements of § 1325. Third, these requirements contain no "absolute priority rule" and hence permit the debtor to keep his property without having to pay creditors in full. Finally, if the Chapter 13 plan is not confirmed, no creditor can file a plan of liquidation and the debtor has the absolute right to dismiss his case at any time (§ 1307(b)).

While a farmer may have an easier time of it in Chapter 13, though, there are new problems. Whereas the increased amount of permissible debt (from one hundred thousand dollars unsecured and three hundred fifty thousand dollars secured to an aggregate of one million dollars) under S. 1342 would allow more farmers to have access to Chapter 13, many farmers will still exceed the one million dollar debt limitation. An analysis of the Chapter 11 farm cases filed in the Eastern District of North Carolina, for example, indicates that over sixteen percent of those farmers would not meet the new limitation.

Another problem that the farmer will have in Chapter 13 is posed by the requirement that the plan be filed with the petition (Bankruptcy Rule 3015). Debtors have, under Chapter 11, the exclusive right to file a plan for one hundred twenty days (§ 1121(c)), (two hundred forty under S. 1342), and farm plans are rarely filed prior to the end of the one hundred twenty-day period. Farmers' affairs are far more complicated than those of the average wage-earner who seeks relief under Chapter 13, and it is therefore neither practical nor reasonable to require the farmer to submit a plan immediately upon filing.

We might add that it is also unrealistic in farm cases to require that plan payments commence within thirty days of filing. S. 1342 wisely gives the court the discretion to change this requirement.

The provision that Chapter 13 plans may not modify security interests covering only the debtor's residence (§ 1322(b)(2)) and the provision that Chapter 13 plans may not exceed five years (§ 1322(c)) are also major drawbacks if applied to farmers.

Chapter 11 contains no such limitations. S. 1342 permits modification of security interests on the debtor's residence and extends the time limit to ten years. The extension will be helpful but probably not entirely adequate.

Further, Chapter 13 provides that unless unsecured creditors are being paid in full, the debtor may be compelled to commit all of his disposable income to the plan as a condition of confirmation (§ 1325(b)). Moreover, an unsecured creditor may be able to require a modification of the plan if the debtor's circumstances improve. (§ 1329(a)). As there is no requirement regarding disposable income and no right given unsecured creditors to modify plans in Chapter 11, farmers desiring financial reorganization will doubtlessly find Chapter 13 considerably more restrictive in this respect.

Chapter 13 may present some disadvantages to the farmer-debtor; however, farm creditors are faced with even more serious disadvantages under Chapter 13.

The Creditor and Chapter 13

Under Chapter 11 many farmers propose plans that call for the liquidation of much of their property in the hope of keeping their house and some acreage for farming. Chapter 13, however, is an unsatisfactory vehicle for selling property because it provides no adequate supervision of the sale. There is no disclosure requirement with respect to the sale. There is no creditors' committee to scrutinize the transaction. Though a trustee is appointed in every Chapter 13 case (§ 1302), the trustee is not a party in interest for the purpose of objecting to sales; the debtor is given the power of sale to the exclusion of the trustee (§ 1303). Prior to confirmation, the debtor must comply with the notice and hearing requirements of § 363(b), but after confirmation the property of the estate vests in the debtor (§ 1327(b)) and compliance with § 363(b) is no longer required. Bankruptcy sales of farm property are often made to the debtor's friends, neighbors, and relatives and need to be closely examined. Chapter 13, lacking a disclosure requirement, lacking provision for a creditors' committee, lacking a trustee as an interested party, and lacking required notice after confirmation, is simply not a good chapter within which to liquidate property.

Another major disadvantage to creditors of permitting farmers to use Chapter 13 is the expanded discharge available to Chapter 13 debtors (§ 1328). There have been a number of reported decisions in which debts of farmers in Chapter 7 or Chapter 11 were determined to be nondischargeable because the debtors converted encumbered property. In re McCloud, 7 B.R. 819 (Bankr. M.D. TN 1980); In re Simpson, 29 B.R. 202 (Bankr. N.D. IA 1983). We have seen a number of such cases in the Eastern District of North Carolina. Such debts, while not dischargeable in Chapters 7 or 11, are dischargeable under the broad discharge in Chapter 13. While the broad discharge may serve as an inducement to wage earners to use Chapter 13, it is inappropriate in a large farm reorganization because of the larger sums of money involved in what is essentially a business rather than a wage-earner situation. Creditors may be justified in complaining if farmers are able to sell collateral without applying the proceeds to debts.

One final disadvantage to creditors is the allowance given the debtor to dismiss his case at anytime (§ 1307(b)). In re Benediktsson, 34 B.R. 349 (Bankr. W.D. WA 1983); In re Gillion, 36 B.R. 901 (D.C. E.D. AR 1983). Wage-earners are provided this option, perhaps rightly. But to allow a large farm enterprise the benefits of bankruptcy relief and to allow it to discard the proceeding whenever it begins to feel uncomfortable is to give free rein to abuses.

Conclusions

Farmers present a nearly unique situation. On the one hand, the farmer has attributes of an individual consumer, and, on the other, the farmer's operation resembles a complex business enterprise. Because Chapter 13 is designed primarily for consumers and Chapter 11 is more adapted to businesses, some provisions of each chapter are better suited for farmers and some of each are not. For this reason, it makes sense to have a separate chapter or subchapter to deal specifically with the farmers' unusual circumstances. This was the approach that Congress took during the Depression when it enacted emergency farm relief legislation. (45 Stat. 1467). From 1933 until March 1, 1949, farmers could obtain relief under a separate section of the Bankruptcy Act of 1898 (§ 75 titled "Agricultural Compositions and Extensions," 11 U.S.C. § 203 expired March 1, 1949). Section 75 of the Bankruptcy Act was enacted by Congress to meet an economic emergency. The legislation was temporary and expired when the emergency passed. (For a good discussion of § 75, see 10 Remington on Bankruptcy Chapter LX, pp. 1-213 [1947]; an excerpt from that chapter summarizing § 75 is attached.)

Allowing the family farmer to use Chapter 13 might cause more problems than it will solve. We believe that a new chapter of the Bankruptcy Code specifically designed to meet the needs of financially troubled farmers while protecting the rights of farm lenders would be more appropriate. At a minimum, such legislation should include: (1) elimination of the requirement to pay "lost opportunity costs" as part of adequate protection; (2) the ability to sell property free of liens pursuant to § 363(f) prior to confirmation; (3) elimination of the absolute priority rule with respect to individuals to permit confirmation over the objection of unsecured creditors while allowing the debtor to retain exempt property or property without equity and (4) a reasonable time within which to formulate and file a plan of reorganization.

If this committee finds that emergency bankruptcy legislation should be part of the solution to the country's farm crisis, we recommend that you consider enacting special legislation tailored to the specific needs of farmers and their creditors.

We very much appreciate the invitation to appear before this joint hearing and to express our views on this very important issue.

> By the Act of March 3, 1933 the Congress deliberately undertook the rehabilitation of the farmers as well as their discharge from indebtedness. Section 75, 11 USCA § 203 offers an embarrassed farmer two remedies. The first is a composition or extension under subdivisions (a-r). This can only be obtained with the consent of a certain number of creditors. Adjudication as a bankrupt is avoided if relief can be obtained under subdivisions (a-r). If however a farmer fails to obtain confirmation of his proposal under subdivisions (a-r) or if he feels aggrieved by the composition or extension granted him he can proceed under subdivision (s). Under subdivision (s) he can be adjudicated a voluntary bankrupt, discharged from his debts, placed in possession of his lands and chattels for three years provided he pays a rent fixed by the court and makes payments on principal if able and finally he can purchase his land free from all encumbrances at an appraised or reappraised value. If he does not redeem a secured creditor may have a public sale from which the farmer can redeem. If the farmer defaults in paying rent or in observance of the conditions on which he is permitted to retain possession of his land he may be ousted and the proceeding can be converted into one in ordinary bankruptcy. The plain purpose of § 75 was to afford relief to farmers in economic distress however severe, by giving them the chance to seek an agreement with their creditors under subsections (a-r), and failing that to ask for the other relief afforded by subdivision (s).

10/ *Remington on Bankruptcy* § 4006 p. 14 (1947).

PREPARED STATEMENT OF THOMAS M. MOORE

I am Thomas M. Moore, one of the two bankruptcy judges in the Eastern District of North Carolina. I have been serving as a bankruptcy judge since 1960. Judge A. Thomas Small is the other judge in our district, and we desire to present a joint statement to the Committees on family farm bankruptcies.

The Eastern District of North Carolina consists of forty-four of the one hundred counties in the State of North Carolina. The Eastern District is predominantely rural and the principal source of income for its inhabitants is from agriculture. The predominant money crops are tobacco and peanuts; however, the farmers also raise substantial crops of corn, soybeans, wheat and produce. In addition, the raising of poultry, swine and cattle provides income for many farmers.

In the fiscal year ending September 30, 1985, we had one hundred twenty-six Chapter 11 cases filed in the district. Fifty-five of these cases or forty-four percent were filed by farmers. We also had forty-nine farmers file Chapter 7 cases. The Chapter 7 farm filings were only five percent of the total Chapter 7 filings in the district. We anticipate a substantial increase in filings by farmers in 1986.

Of the fifty-five farmers who filed Chapter 11 cases in our district, only twenty-four scheduled any cash on hand. Only three of these twenty-four scheduled cash on hand in excess of five hundred dollars. In thirty-six of the cases, the farmer-debtor scheduled secured liabilities of less than one-half million dollars; ten of the cases scheduled secured liabilities between one-half million and one million dollars and nine of the cases scheduled secured liabilities in excess of one million dollars.

My experience in the farm cases in our district supports the following generalizations regarding such cases:

One. The farmers' assets are overencumbered with secured debt. A majority of the Chapter 11 farm cases would be no-asset cases if filed under Chapter 7. In such cases, the unsecured creditors do not receive any substantial dividends, and there is little incentive for them to vote for a plan. In a significant number of cases, the deficiency claim of a single junior secured creditor is sufficient to enable such creditor to control the vote of the unsecured class of creditors.

Two. The farmer's residence is located on the farm. One or more of the security instruments almost always includes the residence, which, along with the farmland and equipment, secures the debt to a farm credit institution.

Three. The Chapter 11 filing is precipitated by a foreclosure proceeding under the power of sale in the security instrument following one or more bad crop years.

Four. At the time the Chapter 11 case is filed, the farmer has little or no money on hand and no available credit. He has no unencumbered property and is unable to protect further the secured creditors or provide security for operating loans.

Five. The Chapter 11 case is filed at the end of a crop year or in the early stages of a new crop year. The farmer-debtor usually needs to complete one crop year under the Chapter 11 to determine whether he can devise a plan which he can fund out of his farm operations.

Six. Most successful farm reorganizations under Chapter 11 are accomplished by a sale of a substantial portion of the farmland and retention by the farmer of a small amount of farm acreage, the residence and the farm equipment essential to farm the scaled-down operations.

Seven. In most cases, the farmer-debtor and the secured creditors, are anxious to sell the assets which are not essential to the reorganization.

Considering the cases filed in our district and the above generalizations, it seems that the family farmer needs assistance in four crucial areas. First, the farmer needs a way to overcome the requirements for providing adequate protection. Second, the farmer needs a procedure for expeditiously liquidating the assets that he is not financially able to retain. Third, the farmer needs a reasonable length of time to formulate and to file a plan of reorganization. Fourth, the farmer needs a way to obtain confirmation without the consent of the affected secured creditors and without the acceptance of the unsecured class of creditors. However, the needs of the farmer must be fairly balanced with the rights of secured and unsecured creditors.

In this context, I would like to address the problems presented by existing law relating to adequate protection and the expeditious liquidation of assets which are not needed for reorganization. Judge Small, in the context of examining the farmer in Chapter 11 and in Chapter 13, will address the other issues: the time needed to formulate and file a plan, the absolute priority rule, the problem of modifying secured debt on retained property, and the rights of creditors.

Protecting Lost Opportunity Costs

The filing of a petition in bankruptcy operates as an automatic stay against any act to create, perfect, or enforce a lien against property of the estate. 11 U.S.C. § 362(a)(4). The secured creditor must file a motion to have the automatic stay lifted in order to proceed with foreclosure. The secured creditor generally files such a motion within thirty days after the bankruptcy petition is filed. The court is generally required to act on the motion within thirty days after it is filed, although there are exceptions to this rule. 11 U.S.C. § 362(e). The court is required to lift or modify the automatic stay if the secured creditor is not adequately protected or if the debtor does not have equity in the property and the property is not necessary to an effective reorganization. 11 U.S.C. § 362(d). The primary basis for lifting the stay in our district is lack of adequate protection. Examples of adequate protection are set out in 11 U.S.C. § 361. At least two Circuit Courts of Appeal have held that "adequate protection" requires the debtor to compensate the secured creditor for "lost opportunity costs" in those cases where the value of the collateral is less than the amount of debt secured by the collateral. In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984); Grundy National Bank v. Tandem Mining Corporation, 754 F.2d 1436 (4th Cir. 1985). The payment of lost opportunity costs requires the periodic payment of a sum of cash equal to the interest that the secured creditor might earn on an amount of money equal to the value of the collateral securing the debt. American Mariner, 734 F.2d at 426; Grundy National Bank, 754 F.2d at 1436. It is intended to compensate the secured creditor for the continued use of the collateral by the debtor.

Our district is in the Fourth Circuit and payment for "lost opportunity costs" is required for adequate protection where the value of the collateral is less than the amount of the secured debt owed the creditor. However, the farmers in our district are unable to pay "lost opportunity costs." In fact, most of them are unable to pay an attorney a reasonable retainer for filing the petition. This requirement for the payment of "lost opportunity costs" is the first and one of the biggest obstacles faced by the farmer-debtor. Unless the requirement for payment of "lost opportunity costs" is modified, the farmer in our district will not have the time to formulate and file a plan of reorganization. However, this issue is not addressed in any of the legislation now pending before the Senate.

Sales Free of Liens

Once the farmer files his petition in bankruptcy and the § 341 meeting is conducted, he realizes that he simply cannot afford to keep all his property and, with the assistance of counsel and a "push" from the creditors, he accepts the reality of his situation and realizes that some of his property will have to be liquidated. At this point in time, it is advantageous to the debtor and the secured creditors for the liquidation process to proceed as rapidly as possible. The automatic stay can be lifted permitting the foreclosure to proceed. However, in almost all cases, the creditors' security instrument includes part of the property to be retained by the debtors. In North Carolina, a lifting of the stay as to part of the property would not permit the secured creditor to foreclose on such property without terminating his rights to foreclose on the remainder of the property at a later time in the event the plan of reorganization is not confirmed. Layden v. Layden, 228 N.C. 5, 44 S.E. 2d 340 (1947).

Under 11 U.S.C. § 363(f), a debtor is authorized to sell property of the estate under certain conditions. One of these conditions is that the secured creditors consent to the sale. There are some cases which raise a question as to whether 11 U.S.C. § 363(f) is adequate authority to permit the preconfirmation sale of a substantial portion of the debtor's assets. In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983); In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983); In re White Motor Credit Corp., 14 B.R. 584 (Bankr. N.D. Ohio 1981). These cases involve corporate reorganizations, and I do not necessarily concede their applicability to farm reorganizations; however, some clarification of this rule might be appropriate. Furthermore, in some cases, the secured creditor is not sufficiently endowed with the spirt of cooperation to consent to the sale, believing that such conduct will better enable him to defeat the proposed plan of reorganization. It would be quite helpful if 11 U.S.C. § 363(f) were modified so as to permit farmer-debtors to sell assets not needed for the reorganization prior to confirmation without the consent of the secured creditor, subject to approval of the court.

Senator EAST. Thank you, Judge Small, and again I thank you both for coming and sharing your thoughts with us and for providing us with a written statement.

Judge Small, if I might ask you a question concerning the length of time involved; both you and Judge Moore, I believe, were indicating that the 5-year period was too short a period?

Judge SMALL. Would be too short for the reorganization of the farmers.

Senator EAST. For the farmers

We have had some thoughts that would increase it over 10 years.

What sort of additional burden, if any, would you see that placing on bankruptcy courts?

Judge SMALL. Well, I do not think it would place much of a burden on the bankruptcy court itself. Once you confirmed that plan, the plan would take care of itself, the payments would be made to the trustee, and the trustee would make payments to the creditors. I do not think it would burden the courts. Actually it would be a pretty perfunctory thing for the trustee to collect them and pay them. And it brings another thought to mind, and that is the fees that are allowed to the trustee. They get a fee of 10 percent up to $450,000 of the amount paid in. It seems to me that probably no judge would allow that much, and that that is entirely an exorbitant amount.

In chapter 11, if you have a trustee, he would only get 3 percent over the amount of $3,000 so there is a great discrepancy there.

Senator EAST. Judge Moore, if I might ask you, do you see any fifth amendment due process problem in allowing the sale free of liens without the creditor's consent?

Judge MOORE. No; I am not sure that I do, Senator East. I think that under the pre-code law that the courts have held that the creditor was entitled to the value of its collateral. And it seems to me that if we provide that creditor with the value of his collateral, as opposed to what we are now doing, which is providing him with the benefit of his bargain, as opposed to the value of the collateral, I do not see any problem with it. But I think it would have to be mandated, of course, by Congress.

Senator EAST. Senator Grassley.

Senator GRASSLEY. Would you give us your opinion on how enactment of the House bill, just as it passed the House, might affect your caseload? We are talking about the House bill that opens up chapter 13 to farmers. At least that is the end result.

Judge MOORE. Well, Senator, in my opinion, I do not think it would seriously impact on our caseload. If that bill were enacted as it is now drafted, I think most practicing attorneys would recognize that they have the same threshold problems in chapter 13 that they now have in chapter 11. That is the question of paying adequate protection. And if that farmer cannot meet those requirements for adequate protection, then you may very well have the same threshold problem that you have in chapter 11 at the present time.

Now, the example I might give you would be if the farmer is going to retain $100,000 worth of equipment and yet his plan payments are for an amount which would not adequately protect the secured lender who has the equipment as collateral, you would have your same threshold problem that you are now looking at. I think the debtors' attorneys, unless you change that bill, would probably not resort to the use of chapter 13. I think you would be falling back on chapter 11 which we now have, and changes made in chapter 11 are not so significant as to generate any increased filings in chapter 11 in my opinion.

Senator **GRASSLEY**. Judge Small, do you think anything differently from what Judge Moore just said?

Judge **SMALL**. No. I would agree with that.

It is difficult to tell because chapter 11, as it is constituted, is not an adequate remedy. There is no way to tell how many farmers would have failed if they had an adequate remedy.

Senator **GRASSLEY**. In your experience, what would be a reasonable amount of time for a farmer to formulate and file a plan under chapter 11? Would it be 120 days, 240 days, left up to the court on a case-by-case basis? Do you have any point of view on that?

Judge **SMALL**. I think 120 days is inadequate. I think 240 comes closer to it, but the court always has the discretion of extending that period. I would say 240 days.

Senator **GRASSLEY**. Any difference on your part, Judge Moore?

Judge **MOORE**. No. I think 240 is a reasonable period of time, but I would like to surface one problem that might be dealt with at some point in time.

It seems to me that in formulating the plan, in those stages where the question really is what property does the farmer feel essential to retain, and what property does the farmer recognize that he can spinoff and turn loose and still have a manageable farm operation. Many farmers have a little bit too much land for what they are trying to do, and a little too much equipment. And they need to scale the operations down.

Many of the ones we see filing now have overextended in acquiring additional land. So, in the initial stages, early on, if they could feel some pressure to make a decision as to what property they need to retain and what property they are willing to spinoff so they could narrow their operations down to a small-scale operation, then I would not find it unreasonable to allow that farmer as much as a year to operate to see if his thinking and if his operation was sufficient to fund a permanent type plan, because most of the farmers that have come in, they have had two bad crop years, and they need a good operating year to really test their ability as farmers to take care of any plans that they may have to reimburse these creditors over a period of time. And if that were worked into the system, I would not find it offensive provided the debtor were in some way required to go ahead and turn loose of the property that was not needed.

Senator **GRASSLEY**. Is it right to assume that that would make some change in the statute to accomplish what you just suggested? And if so, would you have any suggested language to accomplish that?

Judge **MOORE**. Sir, I think it would take some change in the statute. I am not prepared to offer you any suggestions in the change of the language that might accomplish that. But I would be pleased to work on that and provide you with some suggestions.

Senator **Grassley**. Maybe in writing in a couple of weeks, you can send something to us.

Judge **Moore**. Yes, sir.

[Information follows:]

United States Bankruptcy Court
Eastern District of North Carolina

A. Thomas Small
Judge
919-856-4603
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November 22, 1985

Samuel Gerdano
Counsel
Subcommittee on Administrative Practice
U.S. Senate Judiciary Committee
Washington, D.C. 20510

Dear Mr. Gerdano:

Enclosed is a draft of a bill for family farmers which Judge Moore and I believe deals with the major problems which were raised by the panels at the hearings on November 12, 1985. Also enclosed are comments concerning each section of the proposed chapter 12.

The bill would eliminate the need to adequately protect lost opportunity costs and adds the payment of rent as a method of adequate protection. When a farm lender buys farmland at foreclosure, chances are that the lender will have to rent the property until the property is sold. If the farmer pays rent as adequate protection, the lender will receive what the lender would receive if the lender foreclosed.

You mentioned a concern about lengthening the time within which a motion for relief from the automatic stay must be decided. It seems to me that if the standards for adequate protection are relaxed, creditors will recognize that the motions will not be productive and the number of motions will decline.

The bill also facilitates the sale of unnecessary farmland and equipment prior to confirmation and eliminates the absolute priority rule.

Neither chapter 11 nor chapter 13 fits the family farmer and this bill brings together the advantages of both.

The bill also protects the interests of creditors in several ways. For example,

(1) The 30-day time limit on decisions relating to lifting of the stay is retained. This is important to deal with the abusive filings. In most cases, however, no motion will be filed because the adequate protection standards can now be met by family farmers.

(2) The debtor in possession can be ousted based on improper conduct. This has the effect of eliminating the debtor's exclusive period for filing a plan and elevating the trustee from a chapter 13 type status to a position similar to the trustee in chapter 11.

(3) There is no automatic right of dismissal. The debtor has that right under chapter 13, but this would provide a tremendous opportunity for abuse in a large agricultural case.

(4) The creditor may file a plan of liquidation if the debtor cannot file a plan within the exclusive period. It is true, however, that there will be few such involuntary liquidations because of the easier confirmation standards for a debtor's plan and the more stringent confirmation standards for a creditor's plan.

(5) The debtor's discharge is not as broad as it would be under chapter 13. The discharge under proposed chapter 12 would be the same as under chapter 11.

(6) In general, creditors will be better off if farmers can reorganize. Massive foreclosures could have the effect of depressing land values even further and thereby increasing the losses of farm lenders. Allowing farmers to reorganize will help maintain land values and, as long as values are adequately protected, creditors will benefit.

The bill includes the ability of the Attorney General of each state to be heard. This provision comes from S.705 and may not in fact be necessary or beneficial.

As I indicated to you the other day, I will be happy to assist you in any way that you might find helpful.

Very truly yours,

A. Thomas Small

A. Thomas Small
Bankruptcy Judge

ATS:mcc
enclosures

cc: The Honorable Thomas M. Moore
U.S. Bankruptcy Judge

A BILL

To amend title 11 of the United States Code to aid in the reorganization of family farms.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That this Act may be cited as the "Family Farm Reorganization Act."

Section 1. Title 11 of the United States Code is amended by adding the following new chapter 12 titled "Family Farmer Reorganization."

§ 1201. Definitions for this chapter.

In chapter 12 of this title --

(1) "family farmer" means a person whose aggregate debts do not exceed $1,500,000 if not less than 80% of the aggregate amount of those debts, at the time the case commences, arises out of a farming operation owned or operated by such person and, if such person is a corporation --

(A) more than half of the aggregate value of the outstanding equity securities of such corporation are held by one family or by one family and the relatives of the members of such family; and

(B) if such corporation issues stock, such stock is not publicly traded;

except that such aggregate amount does not include a debt for the principal residence of such person unless such debt arises out of a farming operation;'.;

(2) 'debtor" means family farmer;

(3) 'debtor in possession" means debtor except to the extent that the court orders otherwise.

§ 1202. Stay of action against codebtor.

(a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless --

(1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or

(2) the case is closed, dismissed, or converted to a case under chapter 7 of this title.

(b) A creditor may present a negotiable instrument, and may give notice of dishonor of such an instrument.

(c) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided by subsection (a) of this section with respect to a creditor, to the extent that --

(1) as between the debtor and individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;

(2) the plan filed by the debtor proposes not to pay such claim; or

(3) such creditor's interest would be irreparably harmed by continuation of such stay.

(d) Twenty days after the filing of a request under subsection (c)(2) of this section for relief from the stay provided by subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the debtor or any individual that is liable on such debt with the debtor files and serves upon such party in interest a written objection to the taking of the proposed action.

§ 1203. Trustee

(a) If the court has appointed an individual under section 1302(d) of this title to serve as standing trustee in cases under chapter 13 of this title, and if such individual qualifies under section 322 of this title, then such individual shall serve as trustee in the case. Otherwise, the court shall appoint a person to serve as trustee in the case.

(b) The trustee shall --

(1) perform the duties specified in sections 704(2), 704(3), 704(5), 704(6), 704(7), 704(9), 1106(a)(3), and 1106(a)(4) of this title;

(2) appear and be heard at any hearing that concerns --

(A) the value of property subject to a lien;

(B) confirmation of a plan;

(C) modification of the plan after confirmation; or

(D) the sale of property of the estate;

(3) distribute any rental payments received pursuant to section 1222(b)(3) of this title as determined by the court;

(4) advise, other than on legal matters, and assist the debtor in performance under the plan;

(5) ensure that the debtor commences making timely payments required by a confirmed plan; and

(6) if the debtor ceases to be a debtor in possession, perform the duties specified in section 704(8) of this title.

(c) If the number of cases under this chapter commenced in a particular judicial district so warrant, the court may appoint one or more individuals to serve as standing trustee for such district in cases under chapter 13.

(d) The compensation for individuals appointed under subsection (a) of the section shall be limited by section 1302(e) of this title and the percentage fee provided in section 1302(e)(1)(B) for cases under this chapter shall not exceed three percent of payments made under the plan of such debtor, with respect to payments made after the aggregate amount of payments made under the plan exceeds $450,000.

1204. Rights and powers of debtor.

(a) Subject to any limitations on a trustee serving in a case under this chapter or a case under chapter 11 of this title, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(3) and (4) of this title, of a trustee serving in a case under chapter 11 of this title.

(b) A debtor in possession shall perform the duties of the trustee specified in section 704(8) of this title.

(c) Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of the debtor before the commencement of the case.

§ 1205. Authorization to operate farming and other businesses.

(a) Unless the court, on request of a party in interest and after notice and a hearing orders otherwise, the debtor in possession may operate the debtor's farming and other businesses.

(b) If the debtor ceases to be a debtor in possession, the trustee may operate the debtor's farming and other businesses unless the court, on request of a party in interest and after notice and a hearing orders otherwise.

§ 1206. Creditors' Committee

(a) On request of three parties in interest, the court may order the appointment of a committee of unsecured creditors.

(b)(1) A committee of creditors appointed under subsection (a) of this section shall ordinarily consist of the persons willing to serve that hold the five largest unsecured claims against the debtor.

(2) On request of a party in interest and after a hearing, the court may change the membership or size of a committee appointed under subsection (a) of this section if the membership of the committee is not representative of the different kinds of claims or interests represented.

§ 1207. Powers and duties of a committee.

(a) At the scheduled meeting of a committee appointed under section 1206 of this title at which a majority of the members of such committee are present,

and with the court's approval, the committee may select and authorize the employment by the committee of an attorney, and if the debtor's financial records have not been adequately maintained, or the debtor's financial affairs are deemed by the court to be unduly complex, the committee may select and authorize the employment by the committee of an accountant.

(b) An attorney or an accountant employed pursuant to subsection (a) of this section may not, while employed by the committee, represent any other entity in connection with the case.

(c) A committee appointed under section 1206 may:

(1) consult with the debtor in possession of the case;

(2) investigate the acts, conduct, assets, liabilities and financial condition of the debtor, the operation of his farming and other businesses, the means to maintain the farming or other business and any other matter relevant to the case or to the formulation of a plan;

(3) participate in the formulation of a plan, advise those represented by the committee of the committee's determinations as to any plan formulated and collect and file with the court acceptances of a plan;

(4) request the dismissal of the case if there is no possibility of a feasible plan being accepted or if the debtor fails to comply with final orders of the court;

(5) request that the debtor not be a debtor in possession; and

(6) perform such other services as are in the interest of those represented.

(d) As soon as practicable, after the appointment of a committee under section 1206 of this title, the debtor and the trustee shall meet with the committee to transact such business as is necessary and proper.

§ 1208. Right to be heard.

(a) A party in interest, including the debtor, the trustee, a creditors' committee, a creditor, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.

(b) The Department of Agriculture, the Attorney General or the Director or similar chief officer of the agricultural department or agency of any State in which property of the debtor is located may raise and appear and be heard on any issue in a case under this chapter, but may not appeal from any judgment, order or decree entered in the case.

§ 1209. Removal of debtor as debtor in possession.

(a) On request of a party in interest, and after notice and a hearing, the court shall order that the debtor shall not be a debtor in possession --

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case, or similar cause; or

(2) if it is not in the best interest of creditors for the debtor to be a debtor in possession.

(b) On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

§ 1210. Conversion or dismissal.

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.

(b) If a person files a petition for relief under this chapter, but is not a family farmer, such person, if the petition has been filed in good faith, may convert the case to a case under chapter 7, 11, or 13 if such person may be a debtor under such chapter.

(c) If a person files a petition for relief under this chapter, but is not a family farmer, on request of a party in interest, and after notice and a hearing, the court may convert the case to a case under chapter 7 if such person is not a farmer or a corporation which is not a moneyed business or may dismiss the case, whichever is in the best interest of creditors.

(d) On request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter, for cause, including --

(1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;

(2) inability to effectuate a plan;

(3) unreasonable delay by the debtor that is prejudicial to creditors;

(4) failure to propose a plan within any time fixed by the court;

(5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;

(6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under sections 1216 or 1217 of this title;

(7) inability to effectuate substantial consummation of a confirmed plan;

(8) material default by the debtor with respect to a confirmed plan; or

(9) termination of a plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan.

(10) nonpayment of any fee and charges required under chapter 123 of title 28.

§ 1211. Who may file a plan.

(a) The debtor may file a plan with a petition commencing a case, or at any time thereafter.

(b) Except as otherwise provided in this section, only the debtor in possession may file a plan until after 240 days after the date of the order for relief under this chapter.

(c) Any party in interest, including the debtor, the trustee, a creditors' committee, a creditor, or any indenture trustee, may file a plan if and only if --

(1) the debtor is not a debtor in possession;

(2) the debtor has not filed a plan before 240 days after the date of the order for relief under this chapter; or

(3) the debtor has not filed a plan that has been confirmed before 300 days after the date of the order for relief under this chapter.

(d) On request of a party in interest made within the respective periods specified in subsection (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 240-day period or the 300-day period referred to in this section.

§ 1212. Contents of plan proposed by debtor in possession.

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan proposed by a debtor shall --

(1) designate as provided in section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(1) or 507(a)(7) of this title and classes of interests;

(2) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

(3) provide adequate means for the plan's implementation such as --

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving of any default;

(H) extension of a maturity date or a change in interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;

(4) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (3)(B) or (3)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and

(5) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee.

(b) Subject to subsection (a) of this section, a plan proposed by a debtor may --

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated, however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) provide for the curing of any default within a reasonable time and maintenance of payments;

(6) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(7) provide for the payment of all or part

of a claim against the debtor from property of the estate or property of the debtor;

(8) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title.

§ 1213. Contents of plan proposed by a party in interest other than the debtor; impairment of claims or interests; postpetition disclosure and solicitation; and acceptance of plan.

(a) Sections 1123, 1124, and 1125 of this title shall be applicable to plans proposed by a party in interest other than the debtor.

(b) Section 1126 of this title shall apply to plans proposed by a party in interest other than the debtor, except that for purposes of this chapter, the phrase "that have accepted or rejected such plan" shall be deleted from subsection (c) and subsection (d) of section 1126.

§ 1214. Modification of plan.

(a) The proponent of a plan may modify such plan at any time before confirmation, but may not modify such plan so that such plan as modified fails to meet the requirements of

(1) section 1212 of this title if the proponent is the debtor; or

(2) sections 1122 and 1123 of this title

if the proponent is a party in interest other than the debtor.

After the proponent of a plan files a modification of such plan with the court, the plan as modified becomes the plan.

(b) At any time after confirmation but before the completion of payments under a plan proposed by the debtor, the plan may be modified to --

(1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;

(2) extend or reduce the time for such payments; or

(3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan.

Modifications under this subsection are subject to the requirements of section 1216 of this title and the plan as modified becomes the plan unless, after notice and a hearing, such modification is disapproved.

(c) The proponent of a plan, other than the debtor, may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, in accordance with the requirements of section 1129(a) of this title. Any holder of a claim or interest that has accepted or rejected a plan is deemed to have accepted or rejected, as the case may be, a plan as modified, unless, within the time fixed by the court, such holder changes such holder's previous acceptance or rejection.

(d) The proponent of a modification under subsection (c) shall comply with section 1125 of this title with respect to the plan as modified.

§ 1215. Confirmation hearing.

After notice, the court shall hold a confirmation hearing on confirmation of the plan. A party in interest may object to the confirmation of the plan.

§ 1216. Confirmation of a plan proposed by the debtor.

(a) The court shall confirm a plan proposed by the debtor if

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) any payment made or to be made by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable;

(5)(A)(i) the debtor has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the debtor has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides --

(A) for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, except section 507(a)(7), of this title; and

(B) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(7) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim

if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(8) with respect to each allowed secured claim provided for by the plan --

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder;

(9) with respect to the holder of a claim or interest, the plan provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to --

(A) with respect to a claim, the allowed amount of such claim; or

(B) with respect to an interest, if applicable, the greater of --

(i) any fixed liquidation preference to which the terms of any security representing such interest entitle the holder of such interest; or

(ii) any fixed price at which the debtor, under the terms of such security, may redeem such security from such holder.

(10) the debtor will be able to make all payments under the plan and to comply with the plan; and

(11) confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(b) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

§ 1217. Confirmation of a plan proposed by a party in interest other than the debtor.

The court shall confirm a plan proposed by a party in interest other than the debtor if the plan and the proponent meet the requirements of section 1129(a) of this title.

§ 1218. Limitations on confirmation.

(a) The court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of sections 1216 and 1217 of this section are met with respect to more than one plan, the court shall consider the preferences of the debtor, creditors and equity security holders in determining which plan to confirm.

(b) Notwithstanding any other provision of this chapter, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section

5 of the Securities Act of 1933 (15 U.S.C. 77e). In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

§ 1219. Effect of confirmation.

(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired or provided for under the plan and whether or not such creditor, equity security holder, or general partner has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan --

(A) discharges the debtor from any debt that arose before the date of such confir-

mation, and any debt of a kind specified in sections 502(g), 502(h) or 502(i) of this title, whether or not --

(i) a proof of claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

(3) The confirmation of a plan does not discharge a debtor if --

(A) the plan provides for the liquidation of all or substantially all of the property of the estate;

(B) the debtor does not engage in business after consummation of the plan; and

(C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

(4) The court may approve a written waiver of discharge executed by the debtor after the order for relief under this chapter.

§ 1220. Implementation of plan; Distribution; Exemption from securities laws.

Sections 1141, 1143, 1144, and 1145 of this title shall apply to plans confirmed pursuant to sections 1216 and 1217 of this title.

§ 1221. Aircraft equipment and vessels.

Section 1110 of this title shall apply to cases under this chapter.

§ 1222. Adequate protection.

(a) Section 361 of this title does not apply in a case under this chapter.

(b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title, such adequate protection may be provided by --

(1) requiring the trustee to make a cash payment or periodic cash payments, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

(2) providing an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

(3) paying to the trustee for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or

(4) granting such other relief as will

adequately protect the value of property securing a claim or of an entity's ownership interest in property.

§ 1223. Sales free of interests.

In addition to the authorization contained in section 363(f) of this title, the trustee in a case under this chapter may sell property under section 363(b) and (c) of this title free and clear of any interest in such property of an entity other than the estate if the property is farmland or farm equipment.

§ 1224. Claims and interests.

(a) A proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed in a case under this chapter except a claim or interest that is scheduled as disputed, contingent, or unliquidated.

(b) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse.

§ 1225. Emergency care of stock.

The court may authorize the obtaining of credit pursuant to section 364 of this title for the case, including feeding of stock owned by, or in the possession of, a debtor without notice or a hearing where the court finds that credit is needed to obtain funds to care for stock, an emergency exists and that immediate and irreparable injury, loss or damage, will result if authorization to obtain credit for the care of stock is delayed, and that it is in the best interests of the estate to obtain credit and care for the stock. Notice shall be immediately given, by mail, to all creditors of entry of the order authorizing credit under this subsection and a copy of the order entered by the court hereunder shall be attached to the notice.

Section 2. Chapters 1, 3, and 5 of this title apply in a case under chapter 12.

Section 3. This Act is an emergency measure and shall apply with respect to cases commenced under title 11 of the United States Code after the date of the enactment of this Act and before ____________________.

COMMENTS

This Act is designed to provide effective bankruptcy relief for family farmers during a national farm crisis. The Act combines features of chapter 11 and chapter 13 which are advantageous to family farmers as well as provisions needed to protect the rights of farm lenders.

Chapter 12 may only be commenced by the filing of a voluntary petition (11 U.S.C. § 303(a)).

§ 1201 - The definition of family farmer is taken from S.1342, S.1516, and H.R.2211. The debtor will be a debtor in possession unless the court orders otherwise (§ 1201(3)).

§ 1202 - The codebtor stay of 11 U.S.C. § 1301 is applicable to consumer debts in cases under chapter 12.

§ 1203 - The trustee under chapter 12 is very much like the trustee in chapter 13. If the debtor ceases to be a debtor in possession, the trustee in effect becomes much like a trustee under chapter 11.

The compensation for a trustee under this section would in most cases be substantially less than the maximum allowed.

§ 1204 - The debtor in possession, like a debtor in possession in chapter 11, has the powers of a trustee. The debtor would lose these powers if the debtor ceased to be a debtor in possession.

§ 1205 - The debtor in possession, like a debtor in possession in chapter 11, and a debtor in chapter 13, operates the debtor's business.

§ 1206 - A creditors' committee is not automatic in a case under chapter 12. In most cases, it will not be needed because a trustee is appointed in every case. There is no authorization for a committee of equity security holders.

§ 1207 - A creditors' committee may retain an attorney and may also retain an accountant if the debtor's records are not satisfactory. The committee's duties are expanded from those proposed by S.705 (Sec. 2(a) - § 1184) to include a request that the debtor not be a debtor in possession.

§ 1208 - The right of any party in interest to be heard is the same as in 11 U.S.C. § 1109(b). Subsection (b) is derived from S.705 (Sec. 2(a) - § 1183).

§ 1209 - The grounds for removal of a debtor in possession are similar to grounds for the appointment of a trustee under 11 U.S.C. § 1104. The effect of removing the debtor as debtor in possession elevates the trustee who is like a trustee in chapter 13 to a position more like a trustee in chapter 11.

§ 1210 - The debtor may convert to chapter 7, but not to chapter 11 or 13. The effect of this is to eliminate delays which could result from manipulative conversions by the debtor.

Subsection (b) would allow an involuntary conversion to chapter 7 in those cases where the debtor was not a family farmer, and therefore not a qualified debtor under chapter 12. If the debtor is a family farmer or a farmer, the case may not be converted to chapter 7.

§ 1211 - The debtor has the exclusive right to file the plan for 240 days (S.1342, S.1516, H.R.2211) and gives the debtor up to 300 days to have the plan confirmed. The court may reduce or increase this period. In chapter 13 the debtor must file the plan with the petition (Bankruptcy Rule 3015), in chapter 11 the exclusive filing period for the debtor is 120 days (11 U.S.C. § 1121(c)). If the debtor is removed as debtor in possession, the debtor loses the exclusive period.

§ 1212 - What must be in the plan comes primarily from chapter 11. What may be in the plan comes from both chapter 13 and chapter 11. In chapter 13 a debtor may not modify the mortgage on his residence -- that provision was omitted and the debtor would be able to rearrange his home mortgage in chapter 12. The debtor would also have the ability to cure a default over a reasonable period of time -- this is more advantageous than the chapter 11 cure provision (§ 1124(2)).

§ 1213 - If a party in interest other than a debtor proposes a plan, the debtor and the plan must comply with the requirements of chapter 11 with respect to contents of the plan, impairment, and disclosure statements. The debtor would not have to provide a disclosure statement because there would be no voting on the debtor's plan. The voting requirement for plans filed by a party other than the debtor is more stringent than required in chapter 11. In chapter 11 there must be the acceptance of 2/3 in amount and 1/2 in number of those claims and claimants voting. As drafted, § 1213(b) would require 2/3 in amount and 1/2 in number of claims and claimants whether voting or not.

§ 1214 - Modification of Plan. Basically, modifications of the debtor's plan must meet the confirmation requirements applicable to the debtor (essentially chapter 13 requirements) and modifications of the plan of a party other than the debtor must meet the confirmation requirements of chapter 11.

§ 1215 - A confirmation hearing will be held and a party in interest may object and be heard.

§ 1216 - The confirmation requirements for a debtor's plan are essentially those from chapter 13. Subsections 4, 5, 6(B), and 9 are from chapter 11. In chapter 13 a debtor's plan must provide for payment of priority claims in full through the plan. Under subsection 6, administrative claims and priority claims other than taxes may be paid in deferred payments through the plan; taxes may be deferred over a period of six years from assessment as under chapter 11 (§ 1129(a)(9)(c)).

The length of the plan may exceed the 5-year limit in chapter 13 and may exceed the 10-year limit in S.1342, S.1516, and H.R.2211.

§ 1217 - For a plan proposed by a party in interest other than the debtor to be confirmed, it must meet the requirements of chapter 11. There is no provision for a "cramdown" plan filed by a party other than the debtor.

§ 1218 - The court can only confirm one plan and may not confirm a plan over the objections of a governmental unit if the purpose of the plan is tax avoidance or avoidance of securities law.

§ 1219 - The confirmation of a plan has the effect of discharging the debtor from debts prior to confirmation unless provided for in the plan or the order of confirmation. The discharge is not as broad as that in chapter 13 and is the same discharge that the debtor would receive in chapter 11.

§ 1220 - The chapter 11 provisions relating to implementation of the plan, distribution, revocation of an order of confirmation, and exemption from securities laws apply to all cases confirmed under this chapter.

§ 1221 - The special chapter 11 provision for aircraft equipment and vessels applies to cases under this chapter.

§ 1222 - This section eliminates the need of the debtor to provide adequate protection for lost opportunity costs. It also adds another means for providing adequate protection for farm land -- paying reasonable rent to the trustee.

§ 1223 - This section allows debtors to scale down the size of the farming operations by selling unnecessary property. The secured creditor may protect its interest by bidding pursuant to § 363(k).

§ 1224 - As under chapter 11, proof of claims are deemed filed for claims that are scheduled by the debtor. Also the holders of nonrecourse claims are allowed to have unsecured claims for any deficiency.

§ 1225 - Emergency financing may be obtained to feed livestock on an ex parte basis.

Note: The proposed bill does not address the tax problems of the debtor. (See 11 U.S.C. § 1146; and Bankruptcy Tax Act of 1980).

Senator GRASSLEY. I will direct this to Judge Small.

You mentioned that under current law a creditor can file a plan calling for liquidation of the farm debtor if the farmer cannot get a chapter 11 plan confirmed.

As you noted, this is contrary to the intent of Congress to protect farmers from an involuntary chapter 7 liquidation.

Given this congressional intent, and keeping in mind the creditors also, could Congress constitutionally prohibit the filing of a creditor's liquidation plan under chapter 11?

Judge SMALL. I think you could probably do that. It does inhibit the involuntary conversion of a case now. You cannot force them into chapter 7.

As I indicated in our testimony, that if the farmers had a fair shot at getting confirmation, I do not find it offensive at all to say that a creditor plan could be composed and be liquidated. The key, of course, is that they have been given a fair opportunity to have a chapter 11 plan confirmed.

Senator EAST. Gentlemen, we thank you both again for coming and answering questions. We would like to reserve the opportunity to subcommittee members to submit written questions.

So, with that understanding, I thank you, and again we deeply appreciate your making the effort to be here with us.

Our next two witnesses are Mr. Steven A. Seelig, who is Associate Director of the Liquidation Division of the Federal Deposit Insurance Corporation, and Mr. Craig M. Stirnweis, Deputy Comptroller for Special Surveillance, Office of Comptroller of the Currency.

STATEMENTS OF A PANEL CONSISTING OF STEVEN A. SEELIG, ASSOCIATE DIRECTOR, DIVISION OF LIQUIDATION, FEDERAL DEPOSIT INSURANCE CORPORATION AND CRAIG M. STIRNWEIS, DEPUTY COMPTROLLER FOR SPECIAL SURVEILLANCE, OFFICE OF COMPTROLLER OF THE CURRENCY

Senator EAST. Gentlemen, we appreciate your coming and, Mr. Seelig, if you would proceed.

Mr. SEELIG. Mr. Chairman and members of the subcommittees, the FDIC appreciates the opportunity to appear before you to discuss the proposed changes in the bankruptcy status.

I am Steven A. Seelig, Associate Director of the FDIC's Division of Liquidation. Accompanying me this morning is Thomas A. Rose, assistant general counsel for bankruptcy in our Legal Division.

The FDIC is acutely aware of the problems facing this Nation's farmers from two different but related perspectives. In our capacity as insurer of the deposits in the Nation's commercial banks, and as Federal regulator for State nonmember banks, we are concerned that the banking system remain sound and profitable. We are also directly involved in the problems of the Nation's farmers in our capacity as receiver of failed banks. As receiver, the FDIC steps into the shoes of the failed bank and becomes a creditor of a farmer or other borrower of the failed bank. In this capacity, we have had firsthand experience dealing with the problems being confronted by farmers and other businesses involved in agriculture. While these problems are complex and varied, the legislation being considered by the committee represents a piecemeal attempt at relieving farmers' financial problems.

The liberalization of the Bankruptcy Code for the benefit of family farmers clearly will have a detrimental effect on creditors while not granting the debtors the assistance they need. It must be recognized that the agricultural financial system in this country has many players. Aside from those organizations affiliated with the Farm Credit System, commercial banks, numerous small businesses, equipment dealers and manufacturers, as well as others, provide credit to farmers. Any increase in the number of farm bankruptices generated by the proposed changes will adversely affect these creditors. While larger financial institutions may be able to withstand these changes, the potential implications for feed stores, hardware dealers, and other small businessmen who typically provides trade credit to farmers may be significant. The resulting financial problems faced by other merchants will further exacerbate the problems confronted by banks serving agricultural communities.

As of the end of June, there were 3,909 agricultural banks in this country. These are banks with 25 percent or more of their loan portfolio invested in agriculture. Of these banks, 406 are on the FDIC's problem bank list, representing 37 percent of the total number of problem banks in this country. To put this into a different perspective, of the 100 banks that have failed to date, 50 percent were agricultural banks. The FDIC is clearly concerned with the viability and condition of these banks. The proposed changes to the Bankruptcy Code will impact these banks, making it more difficult for them to achieve collections on their credits, and further cloud the value of underlying collateral.

The singling out of family farmers for special treatment with the bankruptcy statute because of their current financial stress appears to give one business group preferential treatment over others. When one combines this preferential treatment with the increased risk to creditors, we are concerned that the group the legislation is designed to help will, in fact, be harmed. The proposed changes in the Bankruptcy Code, rather than benefiting farmers as a group, will have the perverse effect of discouraging lending to agriculture and encouraging the allocation of credit to competing sectors. The largest well capitalized farmers, those that are most creditworthy, will continue to get credit, but the more marginal farmer may find that credit is more difficult to obtain.

Under the existing Bankruptcy Code, both creditors and debtors benefit from the procedures in chapter 13 that allow for more simplified handling of small business reorganizations, as well as the evenhanded approach the code takes toward the interests of all parties. As the culmination of years of experience with prior bankruptcy law and its impact on debtors and creditors, the present Bankruptcy Code is on the whole efficient and fair and operates with a view toward a cohesive approach to distressed debtors' financial problems. Where the financial problems are more complex, the current law and the practices that surround it promote dialog between debtors and creditors to seek a resolution to a mutual problem. In our view, the proposed changes tear at the delicately woven fabric of the code.

While having general concern with the overall implications of the proposed legislation, the FDIC also has specific concerns with selected sections.

The creation of a new debtor whose eligibility is tied to the source of the debt, rather than income, may be so overly broad as to result in benefiting gentlemen, hobby, and tax-shelter farmers more than the true farm family.

The proposed increase from an aggregate of $450,000 to $1 or $1.5 million in the debt allowed a chapter 13 debtor ignores the design of chapter 13 as a streamlined version of reorganization capable of handling the simple debt structure of regular income earners. Such cases are only feasible by virtue of the typically less complex nature of the debtor's affairs. This carefully formulated structure will be destroyed by allowing larger filings by businesses with complicated debt and income streams.

The proposed extensions of time for repaying chapter 13 debts and commencing those payments not only delay the recovery of all creditors but also hurts family farmers in the long run. It is likely that the potential for these lengthy delays will result in farmers having greater difficulty locating short-term credit. Clearly, trade creditors and other short-term lenders will face significantly increased risks if forced to wait an additional 5 years for recovery. To the extent that farming impacts a debtor's ability to schedule payments, the code presently contains sufficient flexibility to deal with this problem.

Finally, given the code's allowance for liberal extensions of time to file a chapter 11 plan, the proposed extension to 240 days for farmers is unnecessary. Bankers and other farm lenders, as active members of agricultural communities, are knowledgeable about their debtors and the current difficulties they face. The current provision encourages constructive interaction between debtors and their creditors toward reaching a solution. This interaction should be further encouraged and not discouraged.

In conclusion, the FDIC believes that many of the remedies envisioned by the proposed Family Farm Credit Rehabilitation Act are already available in the present Bankruptcy Code. Moreover, this legislation is likely to have an adverse effect on lenders and borrowers alike. Financially distressed agricultural banks and other creditors will be further harmed and private credit may become less available to family farmers.

Thank you.

Senator EAST. Thank you, Mr. Seelig.

Mr. Stirnweis.

STATEMENT OF CRAIG M. STIRNWEIS

Mr. STIRNWEIS. Mr. Chairman and members of the subcommittees, I appreciate the opportunity to appear before you to discuss the views of the Office of the Comptroller of the Currency concerning proposed changes in the bank supervisors' treatment of problem farm loans and on legislation that would change the bankruptcy laws as they apply to family farmers. Under consideration are changes that would increase the number of farmers able to qualify for some of the relatively less cumbersome and less financially burdensome provisions of the Bankruptcy Code and would allow some family farmers to maintain control over property they might otherwise have been compelled to liquidate. Providing additional time for family farmers to file a reorganization plan and to make payments under that plan has also been proposed.

While this office shares the Congress' concern about the condition of the agricultural sector and the plight of family farmers, we have serious reservations about attempts to resolve the situation through changes in the Bankruptcy Code or through changes in the OCC's supervisory approach to problem farm credits.

Farm lenders and farmers have a mutual interest in promoting a healthier agricultural sector. Changes in the treatment of family farm bankruptcies, however, would not resolve the underlying causes of the agricultural sector's problems. They would do nothing to improve the income-earning capacity of farm borrowers. Changes to the Bankruptcy Code could, however, have unintended adverse effects on farm banks and local farm economies.

Furthermore, we do not believe that bank examination guidelines should be revised, even if the Bankruptcy Code is amended. More lenient supervisory treatment of loans to bankrupt farmers would seriously distort the bank's reported financial condition without improving the fundamental problems in the agricultural sector.

The financial condition of farm lenders reflects the financial health of the agricultural sector, and both have been poor and worsening. Increases in farm bankruptcies and nonperforming loans to farmers have depressed bank earnings. Return on assets at agricultural banks has fallen 28 percent since 1980. In June of 1985, 610 agricultural banks reported losses, an increase of 160 percent in less than 2 years.

The OCC is confident that the problems facing agricultural banks are manageable. Mowever, efforts to facilitate bankruptcy for family farmers may unintentionally imperil the financial viability of farm creditors. The greatest impact would be on problem agricultural banks where delayed payments and depleted collateral values could seriously erode their earnings and liquidity. At present, 12 percent of all agricultural national banks are considered by the OCC to be problem banks. An additional 25 percent of agricultural national banks are receiving special supervisory attention.

Agricultural banks are dependent on their farm borrowers for timely repayment, just as the farmers are dependent on the banks for loans. Consequently, it is to the benefit of both banks and farm borrowers to reach mutually agreeable solutions when farm borrowers face temporary difficulties in meeting their payment commitments. The OCC is concerned about changes in bankruptcy law that may substantially limit the ability of banks heavily exposed to farmers to realize timely payments on outstanding credits or limit their ability to work out problem loans.

Farmers experiencing difficulties in meeting their financial obligations typically negotiate with their bankers—and perhaps other creditors—in an effort to resolve their financial problems. If the lenders judge that a borrower has the capacity to generate sufficient revenues during the normal course of business to repay the debt, the debt might be restructured or additional credits could be extended. Filing for bankruptcy can destroy efforts to reach mutually satisfactory solutions and replace a cooperative spirit with an adversarial relationship. Changes in the bankruptcy law could also diminish the incentives for farmers facing transitory cash-flow difficulties to negotiate a mutually satisfactory workout with their creditors.

The OCC is also concerned about the harmful effects the proposed legislation could have on the ability of farm banks to serve their local economies. Banks must continue to pay interest on deposits even if they do not receive interest payments on their loans. Proposed changes to chapter 11 could result in the suspension of payments on outstanding debts for more than a year. Under chapter 13, repayment for family farmers would be extended for up to 10 years.

Fortunately, agricultural banks historically have had higher capital ratios than nonagricultural banks, and have therefore been largely able to absorb the losses on farm loans. Nonetheless, if agricultural conditions continue to deteriorate and farm bankruptcies and nonperforming loans to farmers increase, the viability of many more agricultural banks could be threatened.

These developments may also impinge on the ability of affected banks to extend new loans to agricultural borrowers. The majority of bank loans to farmers are operating loans. Extending to 10 years the repayment period for an operating loan substantially reduces its value to a bank that had been expecting repayment within a year. In addition, collateral, in many cases crops or farm equipment, declines substantially in value and may become all but worthless over such an extended period. The resulting reduction in earnings and liquidity may impair banks' ability to meet the credit demands of their communities.

Even banks with sufficient liquidity to extend additional loans would probably restrict their agricultural lending if the likelihood that family farmers would file for bankruptcy were to increase. When evaluating loan applications, bankers will, by necessity, become very selective in extending agricultural loans. Credit will become unavailable, or available only at rates that incorporate a substantial risk premium, to marginal borrowers.

It has been suggested that agricultural banks not be required to recognize losses associated with problem farm credits. For example, in the report on the Family Farmer Bankruptcy Act of 1985, H.R. 2211, which, I should note, the administration opposes, the House Committee on the Judiciary "urges bank regulators to avoid requiring banks to automatically charge off loans as soon as the borrower files bankruptcy." In fact, OCC policies do not require automatic charge off of loans to borrowers who have filed for bankruptcy. However, it is reasonable and prudent for a bank to reevaluate loans to any borrowers, including those filing for bankruptcy, when repayment is uncertain or is likely to be protracted.

The primary purpose of bank supervision is to preserve the safety and soundness of the banking system. To assure institutional soundness, we examine loan portfolios and classify loans when it appears they will not be repaid in part or in total. Failure to reflect accurately the value of assets or to recognize known losses would seriously distort the bank's reported financial condition and income while doing nothing to ameliorate the fundamental problems in agriculture.

Examiners evaluate loans on the basis of the source of repayment, the quality and adequacy of collateral, and the ability and demonstrated willingness of the borrower to repay the loan. When problems are identified, loans are classified as substandard, doubtful, or loss. Standards are applied consistently to all loans, regardless of industry.

The fact that a loan is classified by an examiner does not change the financial capacity of the borrower. It should not be interpreted as an indication that the bank should cease work out efforts and proceed with foreclosure. It is simply a reflection of the examiner's judgment that the quality of the asset is impaired. Banks, not supervisers, decide how to obtain repayment.

The only time that the OCC requires a bank to take a particular problem loan off its books is when that loan is considered uncollectible and, therefore, classified a loss. In cases in which there is some likelihood that a portion of the loan may be repaid, the entire credit will not be written off; the loss may be partial. Again, bank management decides what actions, if any, to take to achieve recovery.

It is to be expected, however, that a bank will be more conservative in its treatment of credits and in its attitude toward extending new credit to outstanding borrowers that have filed, or are likely to file, for bankruptcy. Bankruptcy does impair the value of a credit by reducing the likelihood of timely repayment, reducing the value of a loan's collateral, and by changing the cooperative relationship between the bank and its borrower to an adversarial one. It should be reemphasized, however, that even after bankruptcy, adverse examiner classifications are the result of a judgment of the impaired credit, not the declaration of bankruptcy.

In conclusion, assisting farm borrowers by relaxing bankruptcy laws may have negative effects on farm creditors and local farm economies without improving the long-term viability of the affected farm borrowers. Such legislation may have the unintended effects of impairing the financial condition of agricultural banks, disturbing the provision of banking services to the community, lessening the need of farmers with temporary cash-flow problems to work out mutually satisfactory arrangements with their creditors, and reducing the availability of farm credit.

Furthermore, changes in bankruptcy law ought not to affect bank supervisory procedures. To maintain a sound banking system, examiners must accurately assess the condition of banks. If we fail in this regard, it will erode confidence in our financial system. Lenders, farmers, and regulators have a mutual interest in restoring the health of the farm economy.

Senator **GRASSLEY**. I think I will go vote and then come back so we will have about a 10-minute recess.

[Short recess.]

Senator **GRASSLEY**. Thank you for being patient. I know I was gone longer than 10 minutes. I tried to cover a couple of bases on the farm bill that is just coming up. I have an amendment up on Farmers' Cooperative Associations, and another one on trade adjustment assistance for farm workers. So I guess when we debate farm legislation, I have to choose among competing interests, but I think that because I am chairman of the subcommittee, I have to be here.

Now, for Mr. Seelig, Mr. Stirnweis, and Mr. Rose, if you want to say anything, feel free to contribute.

It is your position then that we in the Congress at this point should do nothing to provide greater access for bankruptcy protection to farmers? Is that a fair summation of your testimony?

Mr. **STIRNWEIS**. Yes; that would be our position.

We feel that the changes that have been proposed would have an adverse effect, particularly on the agricultural banks that we are responsible for regulating.

Senator **GRASSLEY**. Mr. Seelig.

Mr. **SEELIG**. Yes; that would be our position. We feel that better use should be made of the existing statutes to assist farmers with their problems.

Senator **GRASSLEY**. Would that summary you just gave be applicable only to the legislation that we are considering here, or would it also be applicable to some of the other suggestions we have heard dealing with chapter 11?

Mr. **STIRNWEIS**. Yes; I would say so.

Senator **GRASSLEY**. Mr. Seelig.

Mr. **SEELIG**. I think in general, yes. Some of the suggestions that were made earlier for some modifications do not seem out of line.

Senator **GRASSLEY**. If the House bill—and again let me emphasize that I'm referring to the one that passed the House of Representatives, if that were to become law, what do you think it would mean for rural bank failures?

Now, in my State we have had 11 so far this year.

Mr. **SEELIG**. I think the implication is that there would be an increase in the number of bank failures.

Mr. **STIRNWEIS**. I would suggest that there would be a marginal increase in bank failures.

Senator **GRASSLEY**. Then I have to ask to what extent the view that you just gave based upon speculation; what has led you to this conclusion—on what basis is it concluded?

Mr. **SEELIG**. It is based to some extent on speculation. We have no way of knowing what the increase in bankruptcies would be and what the effect would be, not just on banks, but also on small businessmen who are also customers of the banks. Given the weakened condition of a number of banks on the problem bank list, it is reasonable to assume that adding further stress to those institutions' condition would take its toll on some immeasurable number of those institutions.

Mr. **Stirnweis**. We believe there would be an increase in the number of bankruptcies, and as I outlined in my testimony, that would have an effect on the liquidity and earnings of those agricultural banks. Those banks are in a very strained situation, and that additional burden would have an effect on the number of failures.

Senator **Grassley**. Senator Specter, I have just one more question and then I will turn to you.

Senator **Specter**. Senator Grassley, I might, if I may, just say one word.

Senator **Grassley**. You sure can.

Senator **Specter**. I would like to commend you for holding these important hearings. I regret that I have some committees elsewhere.

Senator **Grassley**. For this panel or for other panels as well?

Senator **Specter**. This panel as well as other panels.

Senator **Grassley**. That is perfectly all right.

If you would have those questions back in about 2 weeks.

Thank you, Senator Specter.

[Information follows:]

SENATOR SPECTER'S QUESTIONS FOR THE RECORD ON FARM BANKRUPTCY HEARING, Nov. 12, 1985 [1]

ON S. 1516

I understand that current chapter 13 requirements include a provision that a debtor's first plan payment be made within 30 days after the plan is filed. Yet this legislation contemplates a certain flexibility which will allow the farmer debtor to request a hearing, and a different schedule of payments.

What are the reasons behind this "flexibility?"

Will the request for such a hearing be merely used on every occasion, or will it remain as a safeguard for those who desperately need extra time?

The present debt ceiling for chapter 13 eligibility under this bill is $1.5 million—the House version, I understand, set the limit at $1 million.

How was this figure determined?

If this is the limit, what is the potential number of applicants at this time, and how will this affect the pending case backlog, if any, in the affected bankruptcy courts?

ON S. 705

Why is a "debtor" limited in this bill to an individual farmer, and not to a corporation or partnership, limited in some manner, which is engaged in a farming operation?

Senator **Grassley**. If the House bill became law, what would it mean in terms of increased interest rates on loans to farmers?

Mr. **Stirnweis**. I do not have any exact figures on that. I would presume, again as I said in my testimony, that there would be a higher risk in extending farm credit, certainly to marginal borrowers.

Mr. **Seelig**. I would agree with that.

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[1] Answers not available at press time.

Senator **Grassley**. Although at this point I am not prepared to take issue with you I would suggest that each of the points first made were heard from the banking community just prior to, and maybe a little bit since, Iowa Governor Branstad announced a moratorium on farm foreclosures. On the surface I have not seen the negative impact that bankers said the moratorium would have on loans in my State.

At last week's hearing on this issue, we had some Iowa bankers here. I asked them to brief my staff on this issue. I have not had the opportunity to get the benefit of that briefing yet. But we have not read of problems caused by the moratorium in my State. My Governor does not feel that this happens to be the case, and I only say that to you again to suggest that maybe your point of view is based upon unfounded suspicions. Looking at the situation in my State, and the other States that have had a moratorium could be a track record worth studying. Although from strictly an economic standpoint, I think your assessment would be accurate. But I do not know whether it works out that way in practice.

Are there different standards for classifying farm loans based on whether the bankruptcy is chapter 11 or chapter 13? In other words, is it more likely that the bank will be repaid something if it is a chapter 13 bankruptcy rather than a chapter 11?

Mr. **Seelig**. I do not believe that there is any per se difference. The examiners in classifying the loan would look to collateral coverage, to the likelihood of repayment, either in full or in part, and determine the classification accordingly.

So, to some extent, it would depend on the plan, it would depend upon what coverage or secured interest that remains, and the timeframe under which repayment will occur.

Mr. **Stirnweis**. I would say the same thing, that our examiners would look at the credits in which there had been a bankruptcy filed on the basis of each individual creditor, and would take into consideration the existing factors.

Senator **Grassley**. Thank you.

I do have two questions that I will submit to you in writing but, because of time I would ask those in writing and ask you to respond accordingly.

[Information follows:]

United States Senate

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ALICE R. WILDER, CHIEF COUNSEL AND STAFF DIRECTOR

November 20, 1985

Mr. Craig M. Stirnweis
Office of the Comptroller of the Currency
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20219

Dear Mr. Stirnweis:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 12, 1985 concerning farm bankruptices.

Your response by December 9, 1985, to the following questions would be appreciated:

1. At what point in a bankruptcy would a farmer's loan be considered "uncollectable"? Is it at the time of filing? Is it when the farmer is deliquent on a payment pursuant to a reorganization plan?

2. In your testimony, you asserted that current law promotes a dialogue between debtors and creditors to seek a satisfactory resolution. At our hearing on November 6, 1985, we were told of a central Iowa farmer who offered his major creditor $66,000 more in a Chapter 11 workout plan than the lender could realize in a Chapter 7 total liquidation. But the lender refused the offer and the farmer had to sell out. Without arguing over whether this is an aberration, these situtations do happen -- in your opinion, how should the bankruptcy Code respond to them?.

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck Grassley

CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

CRAIG M. STIRNWEIS ANSWERS TO SENATOR GRASSLEY'S QUESTIONS

Question #1

> At what point in a bankruptcy would a farmer's loan be considered "uncollectable"? Is it at the time of filing? Is it when the farmer is delinquent on a payment pursuant to a reorganization plan?

Answer

Bankruptcy filing and delinquency do not per se result in a loan being considered uncollectable. When a bank determines that a loan, or a portion of it, will not be repaid, then it recognizes a loss. This could occur prior to, at the time of, or subsequent to a farmer's filing for bankruptcy.

Question #2

> In your testimony, you asserted that current law promotes a dialogue between debtors and creditors to seek a satisfactory resolution. At our hearing on November 6, 1985, we were told of the central Iowa farmer who offered his major creditor $66,000 more in a Chapter 11 workout plan than the lender could realize in a Chapter 7 total liquidation. But the lender refused the offer and the farmer had to sell out. Without arguing over whether this is an aberration, these situations do happen -- in your opinion, how should the bankruptcy Code respond to them?

Answer

We believe the Bankruptcy Code ("Code") currently provides sufficient protection to and balances the rights and needs of both the farmer debtor and his creditors.

Chapter 11 provides an opportunity to the farmer, in appropriate circumstances, to reorganize his debts so that he can continue his operation. In considering a reorganization plan, a lender/creditor has a duty to his depositors and shareholders to evaluate the cost of delay in receiving some definite payment, and the potential for the workout succeeding. If, in good faith, the lender determines that the offered plan is not likely to succeed and, in the meantime, the value of collateral may deteriorate and debts increase, thereby reducing the amount of return he will ultimately realize, the Code permits him to reject the offered plan. This protection and right is a necessary element to Chapter 11. However, if the creditor's decision is not made in good faith, the Code authorizes the court to disqualify the creditor from voting. This provision appears to be sufficient to protect the farmer/debtor from bad faith rejections of the plan.

We also would again point out that it is to the advantage of both banks and farm borrowers to reach mutually agreeable solutions when farm borrowers face temporary difficulties in meeting their payment commitments. Working through the bankruptcy is costly in time and legal expenses to the bank. Moreover, filing for bankruptcy can destroy cooperative efforts. Therefore, we do not recommend changes to the Code which would disrupt the careful balance currently established by its framework.

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ALICE B. WILDER, CHIEF COUNSEL AND STAFF DIRECTOR

November 20, 1985

Mr. Steven A. Seelig
Federal Deposit Insurance Corporation
Division of Liquidation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Mr. Seelig:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 12, 1985 concerning farm bankruptices.

Your response by December 9, 1985, to the following questions would be appreciated:

1. At what point in a bankruptcy would a farmer's loan be considered "uncollectable"? Is it at the time of filing? Is it when the farmer is deliquent on a payment pursuant to a reorganization plan?

2. In your testimony, you asserted that current law promotes a dialogue between debtors and creditors to seek a satisfactory resolution. At our hearing on November 6, 1985, we were told of a central Iowa farmer who offered his major creditor $66,000 more in a Chapter 11 workout plan than the lender could realize in a Chapter 7 total liquidation. But the lender refused the offer and the farmer had to sell out. Without arguing over whether this is an aberration, these situtations do happen -- in your opinion, how should the bankruptcy Code respond to them?.

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck Grassley
CHARLES E. GRASSLEY
Chairman
Subcommittee on Administrative
Practice and Procedure

CEG;sgs

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

Office of the Director, Division of Liquidation

December 2, 1985

Honorable Charles E. Grassley
United States Senate
Committee on the Judiciary
Washington, DC 20510

Dear Senator Grassley:

Thank you for your letter of November 20, 1985 regarding my testimony before the Subcommittees on Administrative Practice and Procedure and Courts. You have asked that the FDIC respond to two questions which we are most happy to do.

1. At what point in bankruptcy would a farmer's loan be considered "uncollectable"? Is it at the time of filing? Is it when the farmer is delinquent on a payment pursuant to a reorganization plan?

When analyzing the collectability of any loan, an examiner will focus on the likelihood of repayment based on whether the loan is current and the value of the collateral that the lender may look to. If a farmer files bankruptcy, the loan typically would be classified substandard; however, the loan in all likelihood would probably have been classified previously if the farmer were experiencing severe financial difficulties.

In the event a repayment plan is adopted, and the farmer is performing under the plan the loan may not be classified at all. However, should the debtor default under the plan by being delinquent on payments, and there be no collateral coverage, the loan would be considered uncollectable and be classified as a loss.

2. In your testimony, you asserted that current law promotes a dialogue between debtors and creditors to seek a satisfactory resolution. At our hearing on November 6, 1985, we were told of a central Iowa farmer who offered his major creditor $66,000 more in a Chapter 11 workout plan than the lender could realize in a Chapter 7 total liquidation. But the lender refused the offer and the farmer had to sell out. Without arguing over whether this is an aberration, these situations do happen--in your opinion, how should the bankruptcy Code respond to them?

It is the FDIC's position that the Bankruptcy Code, as presently structured, does provide for and promote negotiations between debtors and creditors to resolve debt problems. We cannot comment on the reasonableness of the outcome in the example cited in your question without more details. Nonetheless, we are happy to outline how the Bankruptcy Code presently encourages dialogue between debtors and creditors and provides debtors with tools to utilize when that dialogue fails.

As a preliminary point, it is important to remember that bankruptcy itself places the debtor and creditor into a new context, one that promotes, if not compels, negotiation. Quite often, the debt problem has already been the subject of lengthy discussions between the debtor and creditor before the bankruptcy petition is filed. At a minimum, the bankruptcy context prompts the debtor and creditor to reassess the problem and potential means for curing defaults and reestablishing regular loan payments.

While a creditor first makes his own determination as to whether or not a loan workout is possible and along what terms, that determination is subject to review, alteration and possible rejection by the Court. Thus, for example adequate protection may be substituted for a creditor's request for relief from the automatic stay; or a plan rejected by a creditor may be confirmed pursuant to the "cram-down" provisions of the Code.

Adequate protection is a mechanismm set up by the Bankruptcy Code to promote negotiation and, where necessary, court mediation. It is the debtor's prerogative, in the first instance, to suggest what may constitute "adequate protection" of the creditor's interest. If the debtor's offer is rejected by the creditor, the court will consider the debtor's offer during the hearing on the creditor's motion for relief from the automatic stay. The court may determine that the debtor's offer is indeed "adequate protection" and, as a result, compel the creditor to accept the offered payments.

The cram-down provisions allow a debtor's plan to be confirmed by the court over creditor rejection of the plan. The existence of this provision acts as a benchmark for both debtors and creditors in negotiating: should neither party be unreasonable, cram-down establishes what the court will enforce. Thus, notwithstanding creditor rejection of a debtor's plan, if Bankruptcy Code standards are met, the plan will be confirmed.

It is the position of the FDIC that the Bankruptcy Code adequately provides procedures for the protection of both debtor and creditor interests and through those procedures greatly encourages the dialogue between the parties necessary for reaching a resolution of their varying interests. As a result, the Code strikes an even balance between debtors and creditors and is one, we believe, that should be maintained.

Sincerely yours,

Steven A. Seelig
Associate Director
Division of Liquidation

Senator GRASSLEY. Thank you each very much.

Our next witness, Mr. Philip S. Lehman, is vice president of the Iowa Farmers Union. He is from my home State of Iowa. And I would also like to mention that we have asked the Iowa Farm Bureau to present testimony as well. They were not able to send a witness and so they will submit testimony in writing.

I would also like to invite any other farm organization that would like to submit testimony on this issue to do so as well.

Mr. Lehman, I would like to thank you for taking time away from your schedule to be here this morning. And I would ask you to proceed as we have previously mentioned.

STATEMENT OF PHILIP S. LEHMAN, VICE PRESIDENT, IOWA FARMERS UNION

Mr. LEHMAN. Thank you, Mr. Chairman.

My name is Philip S. Lehman. I am a grain and soybean farmer from Slater, IA, and serve as vice president of the Iowa Farmers Union. I also am appearing on behalf of the National Farmers Union, a general farm organization representing the interests of about 300,000 U.S. farm and ranch families. With me today is

Robert A. Denman, legislative assistant with the NFU's office here in Washington, DC.

I am honored to have been invited to appear before you to testify on behalf of family farmers on how the U.S. bankruptcy law may be changed to be of more use to family farmers, even if I wish the reason for my appearance did not exist. Unfortunately, people seldom appear before a congressional panel to testify about how well things are working. They normally appear before a committee because things are not working. That certainly is the case at hand.

As Chairman Grassley documented in the hearing last week, the number of bankruptcy filings by farmers in Iowa since 1980 is up substantially. The reasons for this occurrence are clear. Farmers have not received fair prices for their products for over 4 years; interest costs have remained high; supplies of farm products have remained burdensomely high; and the administration's farm policy response to that situation has been inadequate. On top of that, many farmers in the State of Iowa also have been devastated by 2 years or more of drought and other weather-related disasters—events which make it difficult for the best of farmers to survive.

It is difficult to say precisely how many farmers are in severe financial difficulty, in part because of the lag time in collecting economic statistics. Still all the signs are that the numbers are huge and growing steadily. The U.S. Department of Agriculture's benchmark study—now almost 1 year old—indicated nearly one-third of America's farmers were carrying stressful debt-to-asset ratios of 40 percent or more, and only one-third were debt free. Another indication of just how much the situation has deteriorated since then and the speed at which the situation has worsened is that the Farm Credit System now has admitted it cannot survive without Federal help and a turnaround in the price and profit situation in American farming. Less than 6 months ago, FCS leaders were maintaining they had the resources to weather the crisis facing American agriculture.

How does the U.S. bankruptcy law fit into this picture? If it were working the way it was intended when the bankruptcy statutes were revised in the 1970's, many farmers would be using the protection of the Bankruptcy Code successfully to reorganize and restructure their farming businesses in a way to enable them to survive and repay their creditors. Unfortunately, many farmers are finding that the Bankruptcy Code, as it is now written, does not allow that to occur. As has been documented before this subcommittee, most farmers are not eligible to file for chapter 13 bankruptcy, and many of those who file for bankruptcy under chapter 11 find that they are forced into involuntary liquidation when their creditors file reorganization plans of their own as allowed by the law.

In summary, farmers have found the Bankruptcy Code, as it now stands, is not as useful as it could be; changes in the Bankruptcy Code to make it more useful to farmers appear in order.

It is for that reason that the Farmers Union supports the changes in the U.S. Bankruptcy Code proposed in H.R. 2211, approved earlier this year by the U.S. House of Representatives, that would make it easier for farmers to qualify to file under chapter 13 of the U.S. Bankruptcy Code. We believe the simpler provisions of a chapter 13 bankruptcy would be of greater utility to farmers in that it provides farmers with better protections, is less costly than many chapter 11 filings, and provides farmers with time to restructure their operations in a manner so that they can repay their creditors.

Although H.R. 2211 provides substantial improvement in the utility of the bankruptcy law as it relates to farming, you may want to consider changing the section dealing with amount of secured and unsecured debt a farm debtor can have and still qualify for a chapter 13 filing. The $1 million debt ceiling in H.R. 2211 probably is on the short side given the realities of today's farm economy. A debt ceiling of $1.5 million, as embodied in S. 1516, introduced by U.S. Senator Howell Heflin, is more realistic.

Some of the other legislation pending before the U.S. Senate would make some further changes in the bankruptcy law regarding how farmers are treated in a chapter 11 filing. The Farmers Union supports those changes which promote greater utility of chapter 11 bankruptcy by farmers.

As has been brought out in previous testimony before this subcommittee, one of the failings of current law is that a farmer can be forced into involuntary liquidation if creditors reject a farmer's reorganization plan and file one of their own whose net effect is to force a liquidation of assets. Cases have been documented by the Farm Journal where creditors have taken such action, even though they stood to reap a greater return if the farmer's reorganization plan had been accepted. Therefore, the Farmers Union supports the change proposed by S. 705, introduced by U.S. Senator Quentin Burdick, which provides that a reorganization plan can only be proposed by the debtor.

Mr. Chairman, the proposed changes in the U.S. bankruptcy law are not the total solution to the problems facing U.S. farmers and American agriculture today and will not enable all farmers to survive. In fact, some farmers are so far gone that they will not be able to use the bankruptcy law to reorganize and survive even with these changes. The proposed changes, however, will enable some farmers to remain in the business who might not otherwise survive. To that extent, we believe the changes are worthwhile and merit passage.

In conclusion, Mr. Chairman, the answers to many of the problems facing U.S. farmers and American agriculture are outside of the purview of the Senate Judiciary Committee. The Judiciary Committee does not consider legislation affecting profitability, interest rates, or the supply and demand of farm commodities. This committee does have jurisdiction over the U.S. bankruptcy law, however, and can make it a more useful tool to farmers who want to and can reorganize in a way to remain in business. We trust you will make those changes in the U.S. Bankruptcy Code in a speedy manner so that we can save as many farmers as possible in this time of crisis.

Thank you.

Senator Grassley. Thank you, Mr. Lehman.

I have two or three questions. You touched on a lot of questions in your testimony that we would have asked questions about.

First, I will refer to some of the major Federal bank regulators that you just heard. They believe that the House-passed bill will impair the health of farm banks and reduce the availability of credit.

Bankers, last week, seemed to testify along the same lines. So, in your opinion, or in your view, are all these witnesses wrong when they refer to the impact that the House-passed bill would have?

Mr. LEHMAN. I think they have probably overemphasized the effects that this would have on the banks, and talking to my own banker and the experience I have had in dealing with creditors, I think that this could not do anything but help the position of the farmer. I think this thing has to be a shared responsibility. I think the creditor, as well as the farmers, should take some of the responsibility in working out these things.

Senator GRASSLEY. I would like to know if you can give us some idea from your standpoint, either your personal experience or that of your organization, how you might define family farming in the context of the new bankruptcy laws? I would ask more specifically would the definition be related to the size of farm, the amount of assets, the amount of income attributed to farming, or by the amount of debt attributed to farming? We are not limiting you to those that I have suggested.

Mr. LEHMAN. I think it would be unfair to use any one or two of those. I think it would be most of them that you would consider, and I think it would be a family operation that is sometimes more than just one single family. It is an extended family, where maybe a father-son operation, father and two sons, or it would be something that would not include a wad of outside investors, outside of the family.

Our assistant here in Washington has a lot more contact with members than I do. I would like him to explain a little bit.

Senator GRASSLEY. Mr. Denman.

Mr. DENMAN. Mr. Chairman, I would say this matter came up when this bill was before the other body, and various discussions about how best to define a family farmer. And one of the ways at that time they were thinking about was in terms of gross or net income, and the income of a family farm operation had, and I noticed they did not continue that in the bill.

One of the reasons they did not, and the reason I wanted to expand on this a little bit, if you decide to use an income requirement in legislation, you have to be very careful with it, because the problem that you find is that the family farmers who would be filing under a bankruptcy code, they have had a bad year or two, the wife has started working off the farm, and some of the sons would be working off the farm, and sometimes even the farmer himself, in addition to running a hog operation, had several articles, for example, where in one case a farmer, I believe, was from Iowa, he is running a hog operation. He worked with his hogs in the morning. He would go over and work as a groundskeeper at a golf course, and go back to his operation in the evening. You could exclude a lot of those people. Most of them are trying to find all the income they can, trying to save the operation until such time as some probability returns.

Mr. LEHMAN. I think the record shows that 40 percent of the farmers in Iowa, and probably other States too, have more off-farm income than they have farm income. And that is how far it has gone in our State. Not only the farmers themselves. It is way over 40 percent of the wives who have taken off-farm employment and, in most cases, that viable farm operation, the farm wife has to be there to keep that thing going.

Senator GRASSLEY. We heard witnesses at our hearing last week say that the biggest problem farmers have with current bankruptcy laws is trying to stave off attempts to lift the automatic stay.

How would the Iowa Farmers Union or the National Farmers Union feel about a bill that would focus solely on this problem, a bill that redefined what adequate protection is for the farmers' benefit?

Mr. LEHMAN. I might say before he makes his comments that since I have been here in Washington, I have had contact with foreclosures that have been accelerated rather than any forebearance been considered. And this thing—in some way you cannot blame the creditors, but unless there is some extension of time, this thing is going to accelerate so fast that it is going to be something like you have never seen before.

Senator GRASSLEY. Mr. Denman.

Mr. DENMAN. I believe that is one of the biggest problems farmers are facing with the bankruptcy laws right now.

When they go in and they file, and creditors reject the original filing, the creditors come back in and they file one of their own.

I think if you had legislation that will deal directly with that, and we will work with staff and anybody else involved, until such time you consider the precise language and say yea or nay.

Senator GRASSLEY. We will appreciate that very much. And the fact that you do not have an immediate answer is all right. And we would be contacting you even if you did not say you were willing to work with us. But to the extent you have initiated that, you might even think about it in the interim.

Mr. DENMAN. If I could add a little bit there.

We do not believe that H.R. 2211 is the whole answer to the problem facing us. We believe it might be somewhat useful, and we would be glad to work with any changes.

Senator GRASSLEY. We have a couple of questions in writing that we will submit to you, in addition to the ones I just gave you.

[Information follows:]

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November 20, 1985

Mr. Philip S. Lehman
Vice President, Iowa Farmer's Union
c/o National Farmer's Union
600 Maryland Avenue, S.W.
Suite 202
Washington, D.C. 20024

Dear Mr. Lehman:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 12, 1985 concerning farm bankruptices.

Your response by December 9, 1985, to the following questions would be appreciated:

1. Please comment on the usefulness to farmers of the following suggested changes to the Code:

(A) elimination of the requirement for farm-debtors to pay "lost opportunity costs" as part of adequate protection;

(B) adding the ability to sell property free of liens pursuant to section 363(f) prior to confirmation;

(C) elimination of the absolute priority rule to permit confirmation over the objection of unsecured creditors, while allowing the debtor to retain exempt property or property without equity;

(D) providing a reasonable amount of time within which a farmer can formulate and file a plan without having to stave off attempts to lift the automatic stay, under section 362.

If you can, please rank these in terms of their importance to a successful reorganization. In your view, are there other changes that are more important than these noted? If so, what are they and why are they more important?

2. It's been stated that the need for operating income in the immediate post-bankruptcy period is crucial to the farmer's success at reorganization, and that the current Code is of no help in this regard. Do you agree? Can you suggest any changes in section 363 of the Code in this regard? If so, how would these changes fairly protect the rights of secured creditors?

3. It's been suggested that the absolute priority rule presents problems for farmer-debtors. Do you agree? Would it be wise to amend the Code to make it clear that crop proceeds can be retained by the debtor in order to pay creditors, without violating section 1129(b)(2)(B)(ii)? Would this be unfair to creditors?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck Grassley

CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

NATIONAL
FARMERS
UNION

December 10, 1985

Honorable Charles E. Grassley, Chairman
Subcommittee on Administrative Practice
and Procedure
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Chairman Grassley:

Thank you for the opportunity to respond further to your questions on how U.S. bankruptcy law might be altered to make it more useful to farmers in financial difficulty who stand some chance to restore economic viability to their farming operation if they can reorganize their family's enterprise.

The Farmers Union continues to believe some of the most useful changes would be to alter the rules for Chapter 13 filings in a manner that would allow more farmers to qualify for Chapter 13 bankruptcy since that method is simpler and can be done in a quicker manner. Nonetheless, since the questions in your letter of November 20, 1985 appear to deal with possible changes in the code regarding Chapter 11 bankruptcies, we will try to respond. Certainly for some farmers who would not qualify for a Chapter 13 filing under the proposed changes in H.R. 2211, further changes in the rest of the bankruptcy code to fine tune it to the unique circumstances inherent in farm businesses could be useful.

Regarding your first question, the Farmers Union would rank your suggested changes in order of importance to a successful reorganization in the following manner: C, D, B and A. Elimination of the absolute priority rule would probably be the most useful, although we can't stress how important it is that farmers be given a reasonable time beyond current limits in which to formulate and file a reorganization plan without having to fight off attempts to lift an automatic stay.

Concerning question 2, the need for operating income in the immediate post-bankruptcy period is vital to a farmer's hope for success in reorganization, and current law provides virtually no help on that item. Item B that you mentioned in your first question would be of some help in correcting that problem, we believe. To the extent that this will enable a farmer to successfully reorganize in a manner to be an economically-viable farming unit, it would protect the rights of secured creditors.

The Farmers Union also agrees that it would be wise to amend the code to make it clear that crop proceeds can be retained by the debtor in order to pay creditors. We don't believe this to be unfair to secured creditors in that it will better enable farmers to successfully reorganize and thus help protect the value of the underlying security of the creditor's loan (usually land in the case of farm loans) by keeping additional amounts of land from coming on the market, further depressing land values.

Once again, we thank you for the opportunity to respond on this matter of importance. If you have any further questions, please feel free to get in touch.

Sincerely,

Robert A. Denman

Robert A. Denman
Legislative Assistant, NFU
for Philip S. Lehman

Senator **Grassley**. Thank you very much, Mr. Lehman, Mr. Denman.

Mr. **Denman**. Thank you, Senator.

Senator **Grassley**. Our final panel consists of three gentlemen, Mr. Frank Kennedy, University of Michigan, representing the National Bankruptcy Conference; Prof. Terry Anderson of the Creighton University School of Law, Omaha, NE; and Mr. William Needler, an attorney from Chicago, IL.

We thank each of you for your participation. I met Mr. Needler earlier this morning. I will say good morning, Professor Anderson and Professor Kennedy.

Would you proceed then in the way I introduced you?

STATEMENTS OF A PANEL CONSISTING OF FRANK R. KENNEDY, THOMAS M. COOLEY PROFESSOR EMERITUS OF THE UNIVERSITY OF MICHIGAN LAW SCHOOL, ANN ARBOR, MI, AND OF COUNSEL TO THE CHICAGO LAW FIRM OF SIDLEY & AUSTIN; TERRY M. ANDERSON, PROFESSOR OF LAW, CREIGHTON UNIVERSITY, OMAHA, NE, AND OF COUNSEL WITH THE LAW FIRM OF WESTERGREN, HAUPTMAN, O'BRIEN, WOLFE & HADLEY, P.C.; AND WILLIAM L. NEEDLER, ESQUIRE, A FARM-DEBTOR'S ATTORNEY

Mr. **Kennedy**. Thank you, Mr. Chairman.

I have submitted a statement, which is a summary of positions taken by the National Bankruptcy Conference at its last meeting late in October. And on behalf of the conference, I want to express appreciation for this opportunity to present our views.

The submitted statement includes 18 points approved by the National Bankruptcy Conference at its last meeting, and in order to shorten the time that I have with this microphone, I am going to identify about 8 or 9 elements that differentiate the positions of the National Bankruptcy Conference from the features of H.R. 2211.

Generally, the conference was approving of H.R. 2211. I am going to point out about eight or nine points that differentiate our position from that expressed in H.R. 2211.

First, the National Bankruptcy Conference thinks that legislation should be embodied in a separate chapter, maybe chapter 17 or chapter 12.

Second, there ought to be a sunset provision—that is, the legislation ought to have a termination within maybe 5 years. The conference did not take a position as to just how many years. I might say that the point is that we think that this legislation ought not to clutter up chapter 11 or chapter 13 with provisions that may have only a temporary operation.

Third, there should not be a trustee ordinarily, but a trustee should be appointed only under circumstances that would warrant the appointment of a trustee in a chapter 11 case. I may say generally, however, that we go along with the farm-debtor relief legislation passed in the House patterned more on chapter 13 than on chapter 11.

Fourth, there should be a provision for open-end filing of a plan; that is, the time permitted for the filing of the plan ought to be within the discretion of the bankruptcy judge.

Fifth, there needs to be modification of the applicability of automatic stay provision of section 362 and, in particular, there ought not to be an automatic termination of the automatic stay within 30 days after the filing of a request for relief. Generally, the automatic stay provision should apply, but there ought not to be an automatic termination of the automatic stay on the passage of the 30-day period.

Sixth, there ought to be specific provisions dealing with adequate protection. In particular, our proposal is that adequate protection ought to be acceptable in the form of an administrative expense priority, provided there is a showing that the administrative expense priority is likely to be paid; that there ought to be adequate protection against irreparable injury; and that the grant of protection ought to take into account the cyclical nature of the operation of farm-debtors' business.

Seventh, there ought to be provisions for dismissal similar to those in chapter 11.

Eighth, if there exists a cause for the appointment of a trustee, such as fraud or incompetence, the judge ought to have it within his discretion to dismiss, rather than to appoint a trustee, but, in any event, if there is a dismissal for cause, the debtor ought not to have the option of filing another farm-debtor relief petition within 2 years. Dismissal would preclude relief of that kind for 2 years.

Finally, confirmation standards in respect to secured creditors ought to be more analogous to the provisions in chapter 11; that is, the kind of protection in a chapter 11 plan provided for secured creditors should be modeled on chapter 11 rather than chapter 13. As in H.R. 2211, there would be no vote on the plan by unsecured creditors.

Those summarize the principal differences between H.R. 2211 and what the National Bankruptcy Conference would recommend.

[Statement follows:]

PREPARED STATEMENT OF FRANK R. KENNEDY

I am Frank R. Kennedy of Ann Arbor, Michigan, Thomas M. Cooley Professor Emeritus of the University of Michigan Law School and of Counsel to the Chicago law firm of Sidley & Austin. I have devoted over 40 years to the teaching of Bankruptcy, including 17 years at the University of Iowa and 20 years at the University of Michigan. I appear here on behalf of the National Bankruptcy Conference. The National Bankruptcy Conference is a voluntary, nonprofit organization of persons interested in the improvement of the Bankruptcy Code and its administration. The members include United States district judges, bankruptcy judges, bankruptcy practitioners, and professors of law. The Conference has been actively engaged over the course of the past 50 years in drafting and supporting proposed bankruptcy legislation, and representatives of the Conference have appreciated the opportunity, like the one being accorded now, to present its views regarding proposed bankruptcy and debtor relief legislation.

At its Annual Meeting in Washington, D.C., on October 25 and 26, 1985, the National Bankruptcy Conference discussed H.R. 2211, S. 705, S. 1305, and the problems of farm debtor relief generally. At the close of these discussions, the Conference came to the following conclusions and recommends that the conclusions be incorporated in legislation dealing with the subject of farm debtor relief:

(1) Family farm debtor relief should be the subject of a separate chapter of the Bankruptcy Code (*e.g.*, Chapter 17).

(2) The chapter should include a sunset provision--*i.e.*, should terminate on a prescribed date.

(3) Relief provided by the chapter should be available only on a voluntary petition.

(4) A case commenced by a family farm debtor should not be subject to involuntary conversion to a case under another chapter.

(5) Eligibility for relief as a family farmer should be subject to a modest debt limitation (but no specific dollar amount of indebtedness as a minimum was agreed to).

(6) The definition of a family farmer eligible for relief under the chapter should conform to the definition in § 101(17), as proposed in H.R. 2211.

(7) The chapter on family farm debtor relief should generally be modeled more closely on Chapter 13 than Chapter 11.

(8) Only a debtor should be eligible to file a plan.

(9) The time allowable to a debtor for the filing of a plan should be left to the discretion of the court.

(10) The grounds for dismissal specified in Chapter 11 rather than Chapter 13 should apply to the case of a family farm debtor; and dismissal of a family farm debtor's case should preclude refiling for relief as such a debtor for two years.

(11) The grounds for appointment of a trustee under Chapter 11 should constitute grounds for the appointment of a trustee in a family farm debtor case or, in the alternative and in the discretion of the judge, for the dismissal of the case.

(12) Section 362, the automatic stay section, including subsections (d) and (e), should apply in a family farm debtor case, but the provision in § 362(e) for automatic termination of the stay 30 days after a request for relief should be inapplicable.

(13) Secured creditors should be entitled to adequate protection as provided in the Bankruptcy Code but subject to the following modifications: that, in addition to the forms of protection provided for in § 361, such protection may be in the form of an allowance of an administrative expense priority under § 503(b)(1) but only on appropriate findings that such administrative expenses has a reasonable likelihood of being paid; that payments may be required to protect a secured party against irreparable harm; and that the grant of adequate

protection in any form should take into account the seasonal or cyclical nature of a farm debtor's business.

(14) Secured parties should be accorded generally the same treatment in a plan as provided by § 1129 in a Chapter 11 case but without the option provided by § 1111(b); if cramdown in ordered, a secured party should be provided (a) a note secured by a lien for an amount equal to the present value of the collateral, (b) a lien on the proceeds of a sale of the collateral which should be treated like a lien under § 1129(b)(2)(A)(ii), or (c) the indubitable equivalent of its security interest; the five-year limit on the duration of a Chapter 13 plan would not apply to the term of payments of a note in a family farm debtor plan.

(15) The plan should accord to unsecured creditors generally the same treatment as provided by Chapter 13, without any provision for vote on the proposed plan.

(16) The standards of confirmation prescribed by § 1325(a)(4), requiring the plan to provide at least as much as would a liquidation under Chapter 7, and § 1325(b), requiring application of all the debtor's projected disposable income for the three-year period following the date of the first payment under plan, should apply.

(17) No provision should be made for exemptions for a corporate or partnership debtor.

(18) Discharge provisions should be modeled on § 1328 rather than § 1140.

Senator **Grassley**. Mr. Anderson.

STATEMENT OF TERRY M. ANDERSON

Mr. **Anderson**. Thank you, Senator.

I am Terry Anderson. I am a professor at Creighton Law School, and I am also of counsel of a law firm that represents primarily debtors. My statements are my own and do not represent the views of Creighton University or the law firm.

I have submitted a prepared statement which I have placed in the record. In the interest of brevity, I will touch on one or two high points contained in my statement. And also, if I could, just generally on some of the subjects that have come before the subcommittee today.

First of all, I think one of the things we have to recognize is that if we decide to give some special treatment to farmer-debtors, if you create, as I think is the best of these proposed plans, a special subchapter of chapter 11 for the family farmers, we are really doing one thing. We are going to be asking a lot of secured creditors to write down a lot of secured debt. There will be very few farmers who come before bankruptcy courts who will not be asking for a plan which will pay secured creditors the value of their collateral, and the balance will be, in some sense or another, written off, but in the sense that they are secured, but there will be a large writeoff.

It is very hard for me to say whether that is a good idea or a bad idea. I do not think that I am capable of thinking of, or analyzing, that issue in terms of the global terms that apply. But I can tell you one thing from my experience and research in this area, and that is that the farmers' experience in 1985, as compared to the position that farmers found themselves in in 1980, is a cooperative effort. This has contributed to the farm economy as it currently stands and is shared with creditors.

My experience tells me that the typical farmer finds himself in a very difficult position given the way his industry is structured. A typical farmer, over the past 5 years, has found himself increasingly going to his short-term lender, the local bank, and getting operating funds and, in addition, increasing each year, of course, getting a loan to repay the interest on the previous year's operating funds.

What that has done over the past 5 years has increased the debt of most family farmers to at least the full value of their entire operation and in practically all cases, at least the cases that we are concerned with, well over the value of their collateral so that ultimately the responsibility for the situation in which we find ourselves now is a shared responsibility between the family farmer, if you want to call him that, and also the local lenders.

Second, it is very hard for me to estimate the impact that the kind of legislation proposed before this body, or that which is suggested by various witnesses, will have upon the availability of credit for the future. I simply cannot hazard a guess, and I do not know who can. I do know that every time legislation of this sort is proposed, we have the sort of response that Senator Grassley referred to earlier, bankers saying that this is going to result in the failure of banks. As of yet, I have not seen that happen, but I do not know if it is going to happen.

I do know this. It is going to happen in January of 1986, or I know one of the things that is going to happen. The Farmers Home Administration is going to start foreclosing like crazy. As of January 1986, the Farmers Home Administration is going to be back in the ball game. They have been out of the ball game for awhile because there has been a moratorium on their foreclosure efforts. They are going to be publishing regulations which I am very hopeful in the possibility of working with that Administration. But I think, given the large number of FmHA loans out there, we are going to see a large number of foreclosures and more banks fail.

The Iowa Banking Department said they do not expect any more banks to fail in Iowa or in Nebraska at the end of this year, but my guess is that since farmers tend to make their payments in January or February on short-term debt, my guess is that you are going to see some failing in the spring of 1986. We are going to see more bank failures.

I do not know exactly what the impact of this legislation will have on that, and it strikes that we have a problem before us now that does require some action, and it may not be possible to know exactly what impact that will have.

I have one or two specific suggestions with regard to the farmer-debtor experience that I would like to propose.

First of all, during the initial bankruptcy period, and this is the time that a debtor is supposed to be marshaling his forces and getting information so he might draft a plan, it is almost impossible for a debtor to have the resources to accomplish that goal. That is because almost no farmer will enter a bankruptcy without all of his assets encumbered in some fashion or another. The mortgages are drafted in such a way so that everything will be encumbered. Any cash available would be cash collateral, and that requires authorization for its use by the bankruptcy judge, something that can take a long period of time.

How do you pay for someone to provide you with an analysis of your operation to see whether or not it can be restructured, what could be sold or should not be sold? It is impossible if you do not have the money to do it. And a secured creditor can stop the use of cash collateral.

I would suggest that section 552 of the Bankruptcy Code be amended specifically to allow the farmer-debtor to use certain kinds of collateral and some kind of cash collateral, such as milk proceeds from a dairy operation.

Most farmers in Nebraska and in other States have small dairy operations which will provide some limited fixed income. That could be called proceeds from the collateral that a secured creditor would claim. But I think it also could be construed as new collateral that came into existence from the time the bankruptcy petition was filed.

Congress should make clear that this collateral is available for the use of the debtor to pay for the kinds of things that lead to a reorganization. The same thing should be said for crops and cattle. But I suppose I would endorse what has been said before, and that is that this is all window dressing. No farmer-debtor can reorganize with the adequate protection standards of the code as is now written.

We had a case in Nebraska just recently in which a bankruptcy judge ordered the farmer-debtor to make an adequate protection payment of $191,000, or else stand to have the automatic stay relieved. I do not know what kind of cash the farmers have in other States, but in Nebraska most of them do not have $191,000. If they did, they would not be in bankruptcy. Most farmers have very little cash which is available.

Where does the adequate protection payment come from? Presumably it is going to come from somebody's cash. This issue in my mind is well outside what Congress had in mind when it drafted sections 361 through 363 of the code. Congress must change the adequate protection standards. Nothing can go forward unless we do that.

Finally, the absolute priority well which has been discussed by Judges Moore and Small also presents an almost insurmountable obstacle with regard to confirmation of a plan. One of the things that I see happening is that farmers are going to do something about this problem. There are a lot of farmers who are in real trouble, you know, and what they are going to do is take the most efficacious route to keeping their farms. I have never seen such determination in human beings as farmers. They want to keep their land. They want it. It is part of their soul, and they are going to do whatever has to be done to get it. And one of the things they are doing is going into State courts and filing these RICO actions, these actions against banks for fraud and all kinds of causes of action. I express no opinion about them but I am seeing more and more farmers saying bankruptcy is no good for us. Let us go to State court and ask for an injunction because of the fraud committed by the major lender. And in State court you are going to have judges after a time which are going to reflect the views of their constituencies and give those injunctions.

I think this is absolutely foreign to a national bankruptcy law, and I think there are compelling reasons for the Congress to get involved in this now. Professor Kennedy has made some suggestions, and I am frankly in accord with them as to what should be done, and I think Congress simply has to act on this adequate protection issue and other things that I have discussed today.

Thank you very much for this opportunity to be here today.

[Statement follows:]

PREPARED STATEMENT OF TERRY M. ANDERSON

Mr. Chairman, I am Terry M. Anderson, Professor of Law at Creighton University, Omaha, Nebraska. I am associated of counsel with the Law Firm of Westergren, Hauptman, O'Brien, Wolf & Hadley, P.C. This statement is prepared in its entirety by me, and does not represent the views or policy of Creighton University or Westergren, Hauptman, O'Brien, Wolf & Hadley, P.C.

I earned my B.A. and J.D. degrees from the University of North Dakota, and my L.L.M. degree from Harvard Law School. I currently teach courses in commercial financing and have taught courses in Bankruptcy Law. Since the adoption of the Bankruptcy Code I have published in the Bankruptcy Law area, and have written papers for and participated in Legal Education Seminars on Bankruptcy and related topics. I have been a professor at Creighton Law School since 1972.

As of counsel with Westegren, Hauptman, O'Brien, Wolf & Hadley, P.C., I have been involved with Bankruptcy practice, representing principally farmer-debtors.

I.

FARMER REORGANIZATION PROBLEMS

Farmers, in the sense of the small, family farmer, have historically been afforded special treatment under the Bankruptcy Laws. For example, in the Bankruptcy Code, §303 (prohibition of involuntary petitions) and §1112(c) (prohibiting conversion to Chapter 7).

A major reason for this special treatment is the recognition that while farmers are in a business, it is a unique business. There exists no orderly cash flow, no accounts receivable, no regular dependable income. Instead, the farmer spends most of the year with little or no income, experiencing an income gush at harvest time. As a result, the farmer may frequently find himself insolvent during much of the year, in the sense that he cannot pay his debts as they come due. Further, once farming operations are begun, he has little choice but to pursue those operations to fruition. He cannot generally leap back and forth between farming and more traditional employment in order to create cash flow. He is truly controlled, one is tempted to say shackled, by the seasonal nature of his expenses and the postponement of his return.

The seasonal nature of his income also contributes to his financing difficulties. While farmers tend to have long-term real estate loans with fixed amortization schedules, a very significant percentage of their indebtedness takes the form of renewable short-term notes. These notes are typically given at the beginning of the year in exchange for operating cash, to be repaid at harvestime or shortly thereafter.

However well this system may have worked at one time, in the recent past it has been a total failure. In the late seventies and early eighties, as interest rates climbed and crop prices remained stable, farmers increasingly found themselves unable to repay these loans. Their only recourse was to borrow even more cash each successive year to repay past loans and provide new operating capital. At interest rates of seventeen, eighteen, even twenty percent, it was not long before many farmers found their crop income only adequate to pay interest on indebtedness.

Lenders facilitated this progression, since so long as the farmers' land value was rising, the loans appeared secure. Lenders could, by demanding second mortgages on farmland, protect their loans even if the farmer did not have the income to repay those loans.

When this bubble burst, and it has done so with a vengence, both long-term and short-term lenders had little choice but to stop lending new operating funds to farmers in difficulty, and to demand some debt reduction. If no debt reduction was forthcoming, the lender demanded additional security for loans, so as to make the loan appear healthy to the appropriate bank examiners, board of directors or shareholders. The last step in this process. the one which triggered bankruptcy for many farmers, was the lenders' request for a voluntary, orderly, non-bankruptcy liquidation of the farmers' operation.

A. The Farmers' Bankruptcy Choice.

The statistics in Nebraska's Bankruptcy Court bear stark wtness to this process. Through August, 1985, 215 farm-related bankruptcies have been filed in Nebraska. For the years 1973-1980, the records indicate virtually no farm-related bankruptcies werefiled. (Source: United States Bankruptcy Court, District of Nebraska.) Between 1980 and the end of 1985, that number will have thus increased from almost zero to approximately 300.

Of the 215 farm bankruptcies filed in this period, 148 were Chapter 11 petitions. The total Chapter 11 petitions filed, both farm-related and nonfarm-related, was 174 during this period. Thus, not only do most farmers who file bankruptcy elect to file under Chapter 11, but such actions make up almost an 85% majority of all Chapter 11 petitions filed.

In Nebraska, then, it seems apparent that a major part of the Bankruptcy Court's time, at least in Chapter 11 cases, is spent on farm bankruptcies. No doubt the same is true in the other agricultural states.

B. Problems Under Chapter 11.

The farmer seeking an effective reorganization under Chapter 11 faces a variety of problems unique to farming operations. Chief among these problems are (1) the need for operating income in the immediate post-bankruptcy period, (2) the "adequate protection" requirements of §362 and §363 of the Bankrutpcy Code, and (3) the absolute priority rule of §1129(b)(2)(B)(ii).

(1) Operating Income. For reasons probably traceable to the timing of pressure applied by secured lenders, a high percentage of farmer reorganization petitions are filed in the spring months. In Nebraska, 113 farm bankruptcy petitions were filed in the months of February, March and April of 1985. This, out of a total of 215 farm bankruptcies filed through August.

Spring marks the beginning of the farmers' period of highest costs and lowest income. Seed, fertilizer, chemical agents, fuel and cattle feed are only some of his expenses during this period. The Bankruptcy Code, however, makes it very difficult for the farmer to run his business during this initial period.

First, §363(2) limits his use of cash collateral by requiring court approval of such use, and §363(e) permits a secured creditor holding a security interest in that collateral to effectively block that use. Given the breadth of reach of the typical security interest most cash held by a farmer will be cash collateral. Thus, for the first few weeks after filing a bankruptcy petition, the debtor must wait for a court hearing and approval before he can buy feed, fuel and other items necessary in his operation.

S. 705, §1186, providing for emergency care for livestock, gives some relief to the farmer, but not enough. Even assuming credit can be obtained so that feed for livestock can be obtained, other necessary supplies are ignored. The availability of ex parte orders for credit purchases or use of cash collateral should be broadened so that the farmer can adequately plant and fertilize his crops. This is in the best interests of the estate, and will ultimately inure to the benefit of all creditors. A secured creditor whose cash collateral has been used for this purpose can be given a priority lien on the resulting crops to secure repayment of that lien. Section 361(2) could be amended to provide that such a lien would constitute adequate protection for the use of cash collateral. Such use of crop liens as adequate protection for use of cash collateral is a possibility under present interpretations of §361. See In Re Martin, 761 F.2d 472 (8th Cir. 1985).

Operating cash continues to be a problem for the farmer in reorganization proceedings even after this initial period. The prohibitions contained in §363 apply until a plan is confirmed, usually a period of several months. S. 705, and indeed none of the proposed legislation, provides a solution to this problem.

Following a judicial lead, a solution is possible which seems to be both fair and practical. A few Bankruptcy Courts have interpreted §552(b) so as to release some property of the farmer from the reach of security interests, thereby transmutting the proceeds from the sale of such property from cash collateral to simply cash. See In Re Lawrence, 41 B.R. 36 (Minn. 1984); In Re Ydola Pigeon, 13 B.C.D. 107 (N.D. 1985) (milk not covered as product or proceed); In Re Hamilton, 18 B.R. 868 (Colo. 1982) (crops not covered).

These results seem to be fair and reasonable. The farmer undoubtedly enhances the value of crops and farm products by his post-petition labor, feed, fertilizer and the like It is thus not unfair to deny secured creditors the right to attach the full value of such crops and farm products. Further, it is generally the practice of secured parties outside bankruptcy to permit debtors to use or sell these farm products without the secured creditor's permission. State Bank of Palmer v. Scoular Bishop, 349 N.W.2d 912 (Neb. 1984). A good argument can be made in most cases that the secured creditor has under non-bankruptcy law, waived his security interest. In Re Special Abrasives, Inc., 26 B.R. 399 (1983).

Thus, an amendment to §552 specifically incorporating the result of these cases would be consistent with existing legislative policy, See H. R. Rep. No. 595, 95th Cong., 1st Sess. 376-377 (1977), U.S. Code Cong. & Admin. News, 4787, at 6332-3, and would not work an unfair surprise on secured creditors. The property, and cash proceeds, thus freed would ease somewhat the operating crunch the farmer finds himself in prior to confirmation of a plan.

(2) Adequate Protection. Probably more than any other single factor the requirement of "adequate protection" under §361, §362 and §363 of the Bankruptcy Code threatens to limit the vitality of Chapter 11 farmer reorganizations.

The automatic stay afforded by §362 of the Code is central to the Bankruptcy Code's scheme, at least in reorganization proceedings. To the extent secured creditors are afforded relief from this stay so as to proceed against property "necessary for an effective reorganization", §362(d)(2)(B), the goals of reorganization must be lost. Increasingly, however, the concept of adequate protection has been interpreted so as to reach that result.

Relief from the automatic stay can be granted to a secured creditor under §362(d) if he can show the debtor has no equity in the creditor's collateral and that it is not necessary for an effective reorganization, or, "for cause", including the lack of adequate protection.

For most farmers, the collateral, whether farmland, machinery or livestock, will be necessary for an effective reorganization. Further, where the collateral is worth more than the secured debt the "equity cushion" is generally sufficient adequate protection.

Thus, adequate protection is demanded primarily when the creditor is undersecured, and the collateral is necessary for an effective reorganization.

The demand for adequate protection can be made by the secured creditor under §362, relief from the automatic stay, or under §363, conditioning the use or sale of collateral. What constitutes adequate protection may and probably should depend upon the section under which demand is made. However, judicial interpretations of and scholarly commentary on these sections are not in agreement.

If adequate protection is requested under §363, as a condition of a debtor's use of collateral, the measure of protection afforded should be determined by calculating the risk of loss created by that use. In many cases, this presents no special problems. A business debtor in use of trucks, equipment, inventory, and so forth will no doubt cause those things to depreciate. The amount of that depreciation can be calculated, and the risk to be protected against determined. Adequate protection payments here are appropriate, and indeed are the prototype of such payments. The Report of the Commission on the Bankruptcy Laws of the United States, H. Doc. No. 93-137, Pt. II (1973) introduced the concept of adequate protection. The Commission proposal was a codification in In Re Bermec, 445 F.2d 367 (2nd Cir. 1971). Congress adopted the Commission's findings, noting the derivation of adequate protection from In Re Bermec. See Sen. Rep. No. 95-989, 95th Cong., 2nd Sess. 54 (1978), U.S. Code Cong. & Admin. News, P. 5840. Since Bermec involved equipment being used in a debtor's business, the depreciation for which protection was ordered was that caused by such use. This seems a fair and reasonable requirement, since presumably the debtor obtains some value from the use, and this value can be used to make the adequate protection payments.

This application of adequate protection payments creates exceptional hardship and results in unfairness when applied to a debtor-farmer. Lately, real estate secured creditors have sought adequate protection under §363, contending that the farmers' use of the land has caused a decline in value of the real estate during the pendancy of the bankruptcy proceedings. In a case recently decided in Nebraska Bankruptcy Court, In Re Dibbern, B.K. No. 84-1202 (1985), the Bankruptcy Judge ordered the debtor to make an adequate protection payment to the real estate mortgagee of $191,000.00. This amount was determined by finding the value of the land at the time of bankruptcy, and comparing that value to the value of the land at the date relief was requested.

It is clear, however, that this decline in value is of a different sort than contemplated by the Commission or Congress. It is a decline due to market forces, not use. Whether or not the farmer used the real estate would have no bearing on the decline in value. In this sense, it is more akin to obsolesce. Adequate protection payments here seem well outside the purpose for which Congress created that protection. Ordering such payments as in the Dibbern case, which the farmer has absolutely no chance to make, serves no purpose. If he cannot make the payments the stay is lifted, and his land is gone. Obviously, no reorganization plan can succeed without the farmland. It was a combination of economic forces which forced the farmer into bankruptcy. It makes little sense to use these same forces as a basis for denying him the opportunity to reorganize.

Commentators have different views on this subject. Some believe real estate secured creditors should look to equity cushions not adequate protection payments, to compensate for a decline in value caused by market forces. See, Zimmer, Secured Creditors and the Automatic Stay: Variable Bargin Models of Fairness, 68 Minn. L. Rev. 1, 44 (1983). Others believe such payments are necessary to preserve the creditor's bargin. See, Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the

Creditors Bargin, 91 Yale L.J. 857 (1982). I believe the bankruptcy laws should attempt to give the creditor the benefit of his bargin, but they need not improve that bargin. Thus, adequate protection payments for decline in market value should take into account the loss the secured creditor would suffer due to those market forces but for the intervention of bankruptcy. Exactly how this would be done may be complicated, but it could be done. In any event, however, adequate protection payments ordered under §363 should be prospective only. That is, the risk of future loss due to use should be the reference, not compensation for loss already incurred. The better reasoned decisions appear to make this distinction. See, In Re Martin, 761 F.2d 472, 476-477 (8th Cir. 1985).

Where the real estate creditor seeks relief from the stay under §362 due to declining value of the collateral, a similar analysis should apply. It seems clear that the creditor is entitled to some protection, consistent with that which he would possess under non-bankruptcy law. This protection should not require adequate protection payments equal to the post-petition decline. Rather, the debtor should be required to pay only an amount equal to what the creditor would lose absent bankruptcy. This would require taking into account such factors as the foreclosure process, and state redemption laws. It is only after this time has elapsed that the secured creditor will be able to sell the property and stop the decline in value. He should be entitled to no more in bankruptcy.

This view may well require a change in the debtor's ability to utilize non-bankruptcy foreclosure protections should relief ultimately be granted, the Chapter 11 case dismissed or converted, or no plan ever confirmed. In such a case, where the secured creditor has already experienced the delays normally attendant upon mortgage foreclosure, it would be illogical and unfair to force him to suffer those delays all over again. Perhaps a Chapter 11 debtor must take the risk that failure to successfully reorganize will result in the loss of his farm real estate without the usual delays caused by the foreclosure process. This seems a decent bargin. Adequate protection as it currently is applied can deprive the farmer of any opportunity to put a reorganization plan together. Limiting adequate protection payments in the above manner would give him that time.

Recently, adequate protection has also been interpreted to require payments to secured creditors based upon opportunity cost. See, In Re American Mariner, 734 F.2d 426 (9th Cir. 1984). This theory provides that even where collateral is not declining in value the secured creditor is entitled to payments equal to value of his right to liquidate his collateral and use the proceeds. The value of this right would in most cases require payment of interest at the going rate based on the liquidation value of the collateral.

For a farmer in Chapter 11 this would mean that, even where his farmland is not depreciating in value, he would be forced to make interest payments to the secured creditor roughly equal to interest under the mortgage debt. However, interest payments to an undersecured creditor seems inconsistent with §506(b) of the Code, which provides for the accrual of post-petition interest only if the collateral is worth more than the debt.

Some courts have seen this apparent inconsistency as sufficient grounds for refusing to order adequate protection payments for opportunity cost. See, In Re South Village, Inc., 25 B.R. 987 (1982). The South Village judge found it anomolous that an undersecured creditor could, under the guise of opportunity cost, demand and receive interest payments, while an oversecured creditor can only accrue interest. Id, at 997.

The reports accompanying the Bankruptcy Code support the South Village result. H. R. Rep. No. 95-595, 95th Cong., 1st

Sess. 339 (1977), U.S. Code Cong. & Admin. News, P. 6295; S. Rep. 95-989, 95th Cong., 2nd Sess. 54 (1978), U.S. Code Cong. & Admin. News, P. 5840. These reports indicate Congress had in mind the protection of loss in value of the collateral due to depreciation in that value. Perhaps Congress should now make that intention explicit by amending §361 to §363 to exclude adequate protection for opportunity cost.

In summary of this discussion on adequate protection, Congress should address the adequate protection provisions of the Bankruptcy Code, both generally and as it applys to farmers. Farmers cannot generally make the kind of payments currently required in cases like In Re Dibbern, supra, and American Mariner, supra. If they are to be the standard, it means few farmer Chapter 11 proceedings will be successful.

(3) The Absolute Priority Rule. Section 1129(b)(2)(B)(ii) states that a plan cannot be confirmed over the objection of a class of creditors if a junior class retains any property under the plan. This means that a debtor may not keep any property if the unsecured creditors are not paid in full. # Norton, Bankruptcy Law and Practice §63.22.

For a farmer, this rule presents a problem where confirmation of a plan occurs after harvest. In that case, the farmer may possess a significant asset, his crop, which would not be subject to a security interest, and would appear to be available to pay unsecured creditors. This crop, however, will normally be designated in the plan for payment to secured creditors. If a plan is to have any chance of success the farmer must be able to use this crop for such payment. The absolute priority rule can be read to prohibit this use. Legislation designed to help the farmer should make it clear that the crop proceeds can be retained by the debtor in order to pay creditors under the plan without violating §1129(b)(2)(B)(ii).

Conclusion.

In order to make possible effective reorganizations under Chapter 11 the Bankruptcy Code must give the farmer access to operating cash, and time to propose a plan. It must also free him from demands for adequate protection during this period. Given the dollar amounts involved in most farmer bankruptcies, adequate protection payments simply cannot be made.

S. 705, S. 1516 and S. 1342 do not address these problems. They do, however, suggest some other changes, which are generally good.

S. 705 does away with the mandatory creditors committee. That committee frequently has no role to play, and should be optional. Providing for a limited basis for dismissal in §1190, as well as prohibiting creditor liquidation plans in §1187 will give the farmer more time to file his plan. Thus, a farmer who files a Chapter 11 petition in early spring can, if necessary, wait until fall to file his plan without fear of his creditors filing a liquidation plan. Under present law, once a liquidation plan is filed, the debtor must as a practical matter file his own plan or risk confirmation of the liquidation plan. Section 1187 gives the farmer a measure of control over when he files his plan, and this seems wise.

S. 1342 and S. 1516 make two similar changes. First, the exclusive period for filing under §1121(b) is extended to 240 days. This strikes a balance between S. 705 and the present Code. As a practical matter, it probably gives the farmer as much time as he needs without fighting liquidation plans.

Second, both bills attempt to make Chapter 13 available to farmers by increasing the debt limits. Either limit would open Chapter 13 to a significant number of farmers, although $1,500,000.00 would be preferred if the option is to be available to the great majority of farmers.

Chapter 13 does have some advantages over Chapter 11, in addition to being faster and cheaper. Since no one but the debtor can file a plan it removes the threat of a creditor liquidation plan. Chapter 13 makes no provision for creditor committees or examiners, so a debtor tends to be left alone to run his affairs.

Chapter 13 plans may be easierfor farmers to confirm over creditor objections. Unsecured creditors do not vote as a class as in Chapter 11, so that the debtor need only deal with those unsecured creditors who object to confirmation. Further, all the debtor need show to overcome an objection is show that his disposable income is all being applied to payments under the plan.

Chapter 13 has no absolute priority rule, so questions concerning the interests in the farmer's first crops after filing a petition need not be raised.

Finally, on a practical level, Chapter 13 is more attractive than Chapter 11 in that a discharge is not granted under §1328 until all payments under the plan are made. Thus, if a farmer finds he cannot perform under the plan he may, if he wishes, still file under Chapter 7 and obtain a discharge. That may not be available once a plan has been confirmed under Chapter 11.

Creditors may still demand adequate protection under Chapter 13. If, under §1321 of the Code and proposed §1326(a)(1), the debtor has not filed a plan and begun making payments shortly after filing, the adequate protection problems in Chapter 11 seem just as real. Presumably, the same factors that make filing a plan difficult in Chapter 11 cases will apply to plans filed under Chapter 13.

The proposed legislation makes a start, but the other problems met by farmers under the Bankruptcy Code need to be adressed before farmers will truly have legitimate chances for reorganization.

Thank you.

Terry M Ander

Terry M. Anderson

Senator **Grassley**. Thank you, Professor Anderson.

Now Mr. Needler.

STATEMENT OF WILLIAM L. NEEDLER

Mr. **Needler**. Mr. Chairman, members of the committee, it is a pleasure to be here today. I have a small law firm in Chicago of six lawyers who started in 1979, specializing in debtor representation before bankruptcy courts in the United States, not only in Chicago, but in North Carolina, in your State, and other States of the Union. And our firm has participated in bankruptcy chapter 11 proceedings in some 30 States of this Nation since 1979, starting basically in 1979 and into the 1980's with car dealers and truck lines, ending up now obviously with the small businessmen in Chicago and predominantly in the States of Minnesota, North and South Dakota, Iowa, Nebraska, and Kansas in actions for farmers.

Now, let me just say at the outset that we have talked a lot today about 362, the indubitable equivalent, which was fashioned by Judge Learned Hand. And I want to say this, that I believe in my own heart that the term "indubitable equivalent" has been fashioned for farmers against farmers differently than it has been fashioned and used for car dealers. And in specifics when we had chapter 11 dealings with large car dealers that had millions of dollars of assets sitting out front of that dealership. And whether it was in Dallas, Texas, or South Carolina, the court recognized that we had to have an immediate hearing. And I submit to this court today that immediate hearings for cattle and hogs that are dying, I have some that have not been heard yet, and they are pending for 30 days. The judges just are not, because of the workload and the priorities, are not giving priority to use of collateral.

Those judges that handle car cases would recognize, as Congress has said, priorities was to be given to 363 hearings, and those priorities should be done and can be done on notice by phone. That is in the Congressional Record. That is in the record of this committee that passed this bill.

This is not happening. One of the suggestions that we have to use of collateral is that if a hearing cannot be handled expeditiously, then let the debtor's counsel approach an article 3 judge and let that article 3 judge immediately hear that hearing. I am not blaming bankruptcy judges. They are overloaded.

I was with your Judge Thinnes. I know his problem up there. There are many judges that have the same problem. Judge Louis Tarry just had an operation. They have an increased workload.

One thing that will stop an increased workload will stop these unnecessary motions for an immediate stay. We do not get an opportunity to file plans and reorganization. We do not get a chance to work with the debtor on which he should do to restructure his debt. We hardly get the ink dry on the petition. We are working on the schedules to get those within 15 days, and we get four motions for relief of stay. Those motions have to take priority. Those motions have to be heard, and we have to prepare for those motions. We have to get witnesses, we have to get testimony, we have to testify, and we have to be prepared. We have to file responses, we have to do discovery, et cetera, et cetera. The time of the plan has been put on the back burner and now we are off and running. And it is a tough battle because creditors' counsel are well paid and schooled. And another area that you must attend to is that those sections relating to reimbursement of debtors' counsel, because I only say that because debtors' counsel, like ourselves, are a vanishing breed in this world. And we are not being paid. And counsel from out of State are saying you have no right to practice here, and a debtor should have the counsel of his choice to represent him so he feels secure. Many times he can talk better to somebody from outside the district where he feels secure and confident.

This code, Senators, is a series of traps for the unwary. The banker, the farmer has been used to years of going in to his local lawyers in his local town and talking over his farm problems. Today, when he goes into the local lawyer in the farm community, and that lawyer says, yes, I will represent you before the bankruptcy court, and in goes the unwary lawyer into this series of traps and pitfalls, if you will. Within 30 to 60 days, that debtor is out of business and that former lawyer is in terrible trouble.

We have come into many of those cases and attempted to help. Now we have to rebuild. Now we have to bring the stays back in. Now we have to use the removal power. Now we have to get stays on appeal. We have to file appeals. We go in to get a stay pending, and the judge says, Mr. Needler, I will give you that stay but you have to get a bond. Where does he get a bond? He has to go back to the bankruptcy court and get approval for the bond so he can pursue his appeal.

You must make clear, as I believe is clear in the rules, that a debtor in chapter 11 is not required to function and perform a bond to persue his process of reorganization on appeal. I would suggest, Your Honors, that there are many changes that have to be made in the code. I have outlined some of them in 361. You have talked about that. I have outlined many of them in 362. Why cannot we go back to the old standards under relief of stay under the old act, where adequate protection was one of the many considerations and not the only consideration? Why is it not the right of the debtor to effective reorganization and effective rehabilitation the most important thing when it comes to relief of stay? Why do we have to have some term with regard to that?

Again I think you ought to look at the appellate process, at the borrowing processes, and you must allow for emergencies and emergency judges.

Thank you.

[Statement follows:]

PREPARED STATEMENT OF WILLIAM L. NEEDLER

I.

WE OWE FARMERS REHABILITATION

We are here today to testify on behalf of all those American farmers who, through no fault of their own, are about to lose their farms because of the unfulfilled expectations and grand promises made by this government and lenders. In particular, we testify for Charles J. Bellman, formerly a farmer and Democratic Party Chairman of South Dakota and now an inmate in federal prison at Rochester, Minnesota, who is thus unavailable to this Committee. Mr. Bellman's only crime, in our opinion, was his outspoken opposition to the oppression of farmers by the farm credit system and the Aberdeen Production Credit Association of South Dakota in particular. He was convicted of using PCA's collateral, as he always had, in his farming operation.

At the outset, we note that the "self-cleansing" feature of "free market" economics, lauded by those it never affects, is nothing new. Charles Dickens spoke of it when the theory was in full bloom in 19th century England:

> "Are there no prisons?" asked Scrooge.
> "Plenty of prisons," said the gentleman, laying down the pen again.
> "And the Union workhouses?" demanded Scrooge. "Are they still in operation?"
> "They are. Still," returned the gentleman, "I wish I could say they were not."
> "The Treadmill and the Poor Law are in full vigor, then?" said Scrooge.
> "Both very busy, sir."
> "Oh! I was afraid, from what you said at first, that something had occurred to stop them in their useful course," said Scrooge. "I am very glad to hear it."
> - A Christmas Carol, by Charles Dickens

Debtors' prisons, Union workhouses, and Treadmills, in due course, became too expensive to operate, so they were abolished on humane grounds.[1] It was found to be cheaper to encourage those who were "cleansed" out of their jobs by the free market system to seek other employment by doling out welfare payments that assure a "minimally decent life." It was thought that the degradation and humiliation of the dole would be highly effective in getting people back to work so they could pay their debts. In the present farm crisis, we hear a familiar lament:

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[1] That has not prevented the farm credit system, however, from securing from Congress a special debtors' prison law under which Mr. Bellman was convicted. 18 U.S.C., sec. 658.

> ...a farmer who loses his farm and cannot find other work deserves welfare, unemployment compensation or some other kind of government transfer payment to meet his basic needs.
>
> Government, in other words, owes us property. But it does not owe us a profession. We have no right to one job over another. That choice belongs to the free market. The market lets us practice a trade as long as there is a demand for it but tells us to move on to something else when demand fails.
>
> Government did not subsidize the income of blacksmiths when people started riding cars. Government expected blacksmiths to find other work. Farmers should be expected to do the same -- as they have for nearly two centuries.
>
> When the farm support program began in the Depression, the administration said it was temporary. Fifty years later it is time for government to keep that promise.
> Robert Gilmore, Perspective Chicago Tribune, 2/28/85

Regrettably, the history of welfare payments teaches that they have not been as inexpensive and effective as once thought. They now comprise such a staggering portion of the federal budget and deficit that further additions cannot be easily accommodated or tolerated.

Clearly, a more productive solution is to be found elsewhere and no doubt lies in encouraging Americans, where possible, to profitably pursue professions they know and like. Where our fellow Americans have failed in their professions for some reason, our problem is how best to offer a fresh start. We do not think that such important problems and their solutions should be left to the "self-cleansing" of the "free market".

For reasons all too clear, only in economic matters is no intervention by the government thought to be best -- i.e. the most efficient economy is one that is left to run by itself. Such is a fiction fostered by the managers of American business who prefer to be left to their own devices. The history of leaving business managers to their own devices, however, is as sorry as the history of workhouses, debtors' prisons and welfare payments. Even sorrier is the record of American business in offering and encouraging fresh starts.

American industry does not envision itself in the business of offering fresh starts. The lending business, in particular, would prefer its money back at the first sign of difficulty or, as it is fond of providing, "when lender shall feel insecure."

It is the ambition of our government and its people to offer a fresh start to bankrupt Americans by allowing them to reorganize their affairs so that they become once again productive and self-reliant. We say that such reorganizations are preferred to a liquidation of assets and the human misfortune, loss of dignity, and destruction of productivity that inevitably attends.

Accordingly, a crowning glory of American jurisprudence was the Bankruptcy Act of 1898, which for some 80 years served this nation conservatively, but well, in offering an opportunity to bankrupt Americans to reorganize. While perhaps cumbersome in some of its aspects, the Act nevertheless permitted debtors the time and means to reorganize, if at all possible. In most jurisdictions, the Act was liberally construed in favor of the Debtor and his reorganization efforts -- an attitude despised by creditors whose collection efforts were thus stymied. Many assaults were made upon the Bankruptcy Act; but it was not until 1978 that lenders succeeded in getting Congress to abolish the Act and substitute a Bankruptcy Code favorable to themselves -- just in time for the farm financial crisis of the 1980s. So biased is the Code in favor of secured creditors that many bankruptcy judges believe that a debtor may not reorganize without their consent.

The 1970s saw vast expansions of credit freely and wantonly given. Farm land prices and all other farm prices were permitted to drastically rise in the face of radically increasing demands for farm products. Farm land prices soared 12-fold from 1950 through 1979. In the 1950s, annual interest expense was only 17% of average income from assets, but by 1979 exceeded 50 percent. Presently agriculture is carrying as much as $100 billion more in debt than it can realistically support. (The Outlook, Wall Street Journal, Mon., Aug. 26, 1985). All of this could have been easily avoided by controlling exports, adjusting farm supports gradually downward; restraining interest rates to modest levels; and restraining the rise of the dollar against foreign currencies.

Instead, as worldwide demand for U.S. grain and fiber boomed, the Government told farmers to farm fence-to-fence and at the same time advised that costly new machines and methods could greatly enhance production and profits. Suddenly, farm land was regarded as "a scarce resource in a hungry world." By this time bankers were going from farm to farm, like Fuller Brush salesmen, urging farmers to borrow. The future seemed secure and bright indeed. Farmers bought enormous amounts of machinery and additional land at greatly inflated prices and interest rates. Debt grew from $50 billion at the start of the 1970s to $200 billion in January, 1985. (See Time Magazine, 2/18/85, p. 27-8). Ordinarily, farmers who for generations have been taught by their fathers not to overextend themselves, would never have participated in such folly, but this time they were assured that nothing could go wrong by the government and by the nation's more influential and respected lenders and leaders. The stage was set for collapse.

In 1981, the bubble burst as world-wide recession slashed demand for U.S. farm products abroad and prices drastically fell. Suddenly, farmers could no longer make enough from crop sales to cover repayment of their loans. As a result, demand for land and machinery dried up and the value of both dropped precipitously. (See Time Magazine, 2/18/85, p. 28). Overnight, many farmers found they had little or no equity in their land, and thus no ability to borrow further. Because farmers could no longer repay their loans, lenders began to experience heavy losses and in some cases those losses proved fatal. Over the past year, the number of problem banks have drastically and alarmingly increased and the farm credit system generally admits it is insolvent and will have to get a government bailout in the billions to survive.

We have reached this sorry state not because of government intervention, but rather because of the lack of proper and enlightened intervention and because of government and lender bad advice. It is because the government failed to intervene in a conservative and responsible manner to prevent the boom-and-bust cycle that we now must pay so dearly -- because the government, encouraged by industrial leaders who know far better, added fuel to the speculative fire by urging farmers to drastically and profligately expand and "modernize" their operations.

As stated by Andrew H. Malcolm in the New York Times some months ago, "...many small-town bankers, who were telling farmers only a few years ago that they had to borrow and expand to survive, now visit the same homesteads with financial projections requiring the farm to be sold after generations in the same family".

The plight of the rural small-town banker is particularly poignant, for right behind him is the Federal Depositors Insurance Corporation (FDIC) ready to throw out old management and ownership of the bank. (See "The Family Farm, Going, Going, Gone," Life, Nov. 1985, p. 145). This federally-backed corporation makes it virtually impossible for a farmer to receive any sort of meaningful forbearance and help from the banker he has known and trusted for years in his hometown. The banker has no choice whatsoever. If he is not hard-hearted and tight-fisted enough for the job, the FDIC will take over and show everyone, including the ruined banker, how to foreclose and dispossess the farmer. And, it isn't just small, rural banks that have this problem. Production Credit Associations are under similar pressure. Witness the Production Credit Association of O'Neill, Nebraska, recently taken over by federal marshalls and the farm credit system. Farmers can expect no help and forbearance from PCAs.

Farmers have pledged all they own to their secured lenders, for those were the conditions lenders blithely soft-pedalled when they went door to door selling their loans. Now farmers must care for the collateral they pledged to lenders 24 hours a day, 7 days a week; they must feed and continue to grow their pledged stock and crops; and yet courts and lenders often won't permit them enough out of their estate to put food on the table. One family in Fulda, Minnesota is presently being supported by a grandmother's widow's mite, while creditors prevent their reorganization by all means at their disposal. Their attorney has been likened to a carpetbagger selling the "elixirs" of reorganization to dying farmers, and he has been ordered to return his retainer from a third party on the ground that the Bankruptcy Code as interpreted in an unpublished opinion of one of the Minnesota District Courts does not permit the reorganization of a farmer who because of a decline in land values has little equity left in his land. Interestingly enough, the U.S. Trustee's office, which desires to be expanded by this body, was chief among the voices opposing reorganization of this farmer and has been carrying on a crusade against the attorney involved. The case is presently before the 8th Circuit U.S. Court of Appeals and at least one judge has expressed his dismay.

We were under the impression that Congress created the office of U.S. Trustee to handle the administrative details of bankruptcy cases, thus freeing judges from work-a-day tasks, for that is the way it works in the Northern District of Illinois in Chicago where our firm is located.

But in many jurisdictions Congress, by supplying a U.S. Trustee, has provided another lawyer for creditors at taxpayers' expense who writes briefs, makes motions and in general takes an adversarial position to the Debtor on the excuse of preserving the estate. Creditors do not need another lawyer at taxpayers' expense to forward their interests. Creditors already have batteries of the very best lawyers money can buy, and they have rigged the Code and persuaded Courts to award inadequate fees so as to discourage attorneys from representing Debtors. In some jurisdictions, Debtor's attorney is forced to wait until the end of the case to receive any award, so that the Court can evaluate what "contribution" he has made to the estate with the guideline that whatever is awarded should be on the low side.

This means that in many cases the Debtor's attorney must defer to the whims of the Bankruptcy Judge in order to have any hope of reward at all. Furthermore, Debtor's attorneys are forced to charge very substantial hourly fees and take equally substantial retainers in order to alleviate a small part of the risks involved in not being paid. A Debtor's attorney cannot exist without being rewarded.

Our firm, because it specializes in representing Chapter 11 Debtors has well over a million and a half dollars in receivables, most of which it cannot collect. Our supporters say this is evidence of the firm's devotion to a Chapter 11 debtor and its willingness to fight any battle to save them, expensive or not. Our detractors say this is evidence of the firm's attempt to harrass creditors and delay the inevitable. But the grim alternative to a strong adversarial approach is to do what lenders want and either (i) give the debtor the expedited funeral desired or (ii) indenture the debtor to the slavery of years of work and payment required by the lender. "Consensual reorganization" is hardly the answer; nor do numbers of confirmations tell a meaningful story. The future welfare of the Debtor depends entirely upon what basis he is confirmed.

Debtors are never going to be confirmed on a fair basis unless the quality of Debtor representation is on a par with that of creditors. Congress needs to recast the role of U.S. Trustees so that they become of assistance to Debtors and their attorneys, thus evening out a gross imbalance. Additionally, Congress needs to make it easier for a Debtor's attorney to be rewarded, whether or not he happens to prevail in the end. Moreover, Congress needs to simplify and liberalize the bankruptcy laws so that an average practitioner can effectively represent debtors. As it stands, creditors have rigged the Code so that an average practitioner, should he dare to represent a debtor, is an easy victim to the creditor's specialist who knows his way around the complicated, hundreds of pages of laws and rules that serve as traps for the unwary.

A creditor's attorney hastens to explain to Debtors that he can only represent the lender side because creditors would retaliate and deprive him of their business should he represent debtors. Actually, Debtor's representation is too risky and unprofitable, especially when compared with the enormous and sure profit to be made representing creditors. Of course, there is the exception of the temporarily-embarrassed, well-heeled large industrial firm that needs Chapter 11 protection -- a representation a creditor's attorney is all too eager to entertain. The bankruptcy laws need to be re-rigged to more favor debtors, as the present farm crisis proves. When debtors and creditors are evenly matched they can then meet in a spirit of common understanding, rather than in a spirit of hostility and recrimination, to solve their mutual problems.

Attached as Appendix A is a letter from Charles J. Bellman to Judge John B. Jones, outlining how he was convicted for nothing more than using the proceeds of collateral pledged to PCA as he always had in his farm operation.

Mr. Bellman resisted PCA's arbitrary and unconscionable demands. After PCA loaned Bellman Farms $1,083,000.00 on March 25, 1981, it put the loan into collection on July 2, 1981 without notice to Bellman farms. PCA could not afford to allow Mr. Bellman to assert his rights and stand as an example for other farmers to follow. Even the bankruptcy court has recognized the hatred of PCA in the Bellman case. Who can deal with an organization forced to engage in such vendettas?

It is true that Mr. Bellman had a trial before a jury. It is also true that all too many men have stood accused and suffered unjust imprisonment because our system of justice is not perfect. We would ask this body the following:

(i) is there one among this body who, under these circumstances, would be caring and diligent enough to seek the pardon of Charles Bellman;

(ii) since there are other PCAs attempting to repeat the Bellman coercion by seeking criminal indictments, or by blocking reorganization, or by preventing discharge, etc., should not these tactics be proscribed and condemned by Congress; and

(iii) should not Congress amend the provisions of 18 U.S.C., sec. 658 to provide: "notwithstanding this or any other law, under no circumstances shall a farmer who has used, in his farming operation, a lender's collateral, its product, or its proceeds, suffer any criminal liability or penalty whatsoever except under the common or statutory law of the various States, where applicable.

Above all, it should be remembered that there is an answer to former Budget Director David Stockman, who said:

> "For the life of me I cannot figure out why the taxpayers of this country have the responsibility to go in and refinance bad debt that was willingly incurred by consenting adults who went out and bought farm land when the price was going up and thought that they could get rich..."

The taxpayers of this country have the responsibility and duty to bail out farmers because taxpayers elected the government that failed to responsibly intervene to prevent boom-and-bust, but rather encouraged it. The government owes farmers rehabilitation and recoupment because it threw fuel on the speculative fire by encouraging farmers to farm fence-to-fence, and to take on insupportable debt. Taxpayers must pay because we owe farmers for our government's mistake, irrespective of whom or what administrations are to blame. Anything short of that is morally unacceptable and a betrayal of fellow Americans upon whom we all depend for our health and well-being. The suggestion that farmers are dying from natural causes is preposterous in the extreme.

A member of the present administration has recently suggested that the time was never brighter for a young person to be entering farming now that land values and prices of used equipment, etc. have eroded.

While we can understand the desire to encourage and interject a ray of hope in a bad situation, the fact is that at the present time there is no reason why a young person should desire to go into farming -- particularly after witnessing what is now happening to his family, friends, neighbors and others.

Should we fail to help farmers now, all of us will feel the effects when the "free market system self-cleanses" and drives a whole generation of young people from the farming profession, thus assuring eventual scarcity and unbearably high prices. We are reminded that farming is not an easy occupation and that American agriculture succeeds where that of other nations fails because of the honesty, dedication and hard work of the American farm family. Our family farm system is more fragile than some suspect. If our young people are lost to farming, they will not be back.

Americans do not desire to be self-cleansed into the hardship of rampant inflation or deep depression. We depend upon our government to prevent such calamities and provide for our common, general welfare, as is its duty.

With our indebtedness and duty to farmers thus outlined and defined, we turn our attention to how best rehabilitation might be achieved.

II.

HOW DO WE MAKE FARMERS WHOLE?

Clearly, the most effective and fair method of making farmers whole should begin with a mitigation of their damages -- namely facilitating their self-help and reorganization. Such could be effectively accomplished by fair bankruptcy laws liberally construed in the farmer's favor.

If it were possible, we would simply suggest that Congress repeal the Bankruptcy Code and reenact the Bankruptcy Act of 1898. Most of us are familiar with the Act and it would not be hard to return to the many protections it offered debtors when liberally construed. That, in the end, may be the only practical solution.

Congress must be warned that the Bankruptcy Code is a creditor's act. It has achieved passage only because lenders are organized and debtors are not. The simple fact is that no American expects to become a debtor under the Bankruptcy Code, so there is no group which can be organized to resist the lobbying efforts of highly-organized lenders and their supporters, some of whom enjoy high office in all branches of government. More recent amendments to the Bankruptcy Code illustrate the problem -- none favor debtors except those dictated by a plurality of the Supreme Court of the United States in the Marathon Pipeline case.

Farmers, however, might not have time to wait for the repeal of the Bankruptcy Code, since resistance to that would certainly be protracted and vocal.

Alternatively, as a starting point, this body might consider Amendments to the following Bankruptcy Code sections:

A. SECTION 361

The provisions of section 361 should be amended to clarify the adequate protection definition. It must be established that the "indubitable equivalent" of cash is not only cash, but can be other items of value. Liens on future crops, livestock, or other production items must be deemed to be good adequate protection and not too speculative because they could die or spoil or be subject to price change. Reasonably likely value, not assured value, should be good adequate protection. Judge Learned Hand did not mean by the term "indubitable equivalent" that there must be no risk involved in the "equivalent", for otherwise there never could be a reorganization.

"Going concern value" should be added to the definition of adequate protection. It should be provided that going concern value (i.e. the ability of the operation to generate cash flow and profit) can, standing alone, constitute valuable adequate protection.

This section should be amended to state that the Code be liberally construed to assist the Debtor in his efforts to reorganize, including a liberal interpretation of adequate protection.

The Code should also be changed to make it clear that the decision of the 9th Circuit Court of Appeals in American Mariner, 734 F.2d 426 1984 is abolished, and that Debtors are not required to provide adequate protection for undersecured claims. No adequate protection should be provided because a creditor is delayed by Section 362 from foreclosure or other proceedings.

B. SECTION 362

Section 362 should be amended to provide that no motion for relief of stay can be filed during the first 120 days after the order of relief in Chapter 11 proceedings.

The relief of stay standards under the old Chapter XI Act should be amended and substituted for the present standards under 362 as follows:

1. Is the property which is the subject of relief of stay necessary for the Debtor's reorganization?
2. Is there equity in this property over this claimant's claim?
3. Does the Debtor have a reasonable chance to reorganize?
4. Has the Debtor achieved rehabilitation or is such rehabilitation achievable within the exclusive period for confirmation as set forth under Section 1121?
5. Does the adequate protection offered by the Debtor meet the criteria of Section 361?

Congress should specifically overrule the American Mariner case and Lend Lease v. Briggs Transportation Co., Civ. 3-84-224 (D.

Minn. Sept. 26, 1984), both of which set impossible guidelines for adequate protection in reorganization proceedings.

Section 362 should be amended to provide that the expiration of any right of redemption of any rights under contracts for purchase of real property, which were in existence as of the filing date, are stayed and tolled under Section 362, so that valuable real property rights are not lost by Chapter 11 debtors while they are attempting to reorganize.

Section 362 should be amended to provide that a creditor seeking relief of stay under Section 362 has the burden to establish the nature, extent and validity of his secured claim.

C. SECTION 363

Section 363 should be amended to provide where livestock, perishable merchandise, or other emergency exists as to use of collateral, such application must be heard, hearings completed, and a final order entered within 24 hours of such emergency application. There should be no possibility of dying livestock and crops while creditors wrangle.

If for any reason such emergency hearings cannot be held by the Bankruptcy Court within 24 hours of such filing, it should be specified that the Debtor may immediately proceed and be heard in the United States District Court where the Chapter 11 proceeding is filed.

In no event, should any Debtor who has filed Chapter 11 be denied reasonable living expenses from the Chapter 11 estate for any reason whatsoever including the fact that assets are pledged.

D. SECTION 364

Section 364 should be amended to provide that where an emergency application for credit is filed, such application must be heard and hearings completed, and a final order entered within 48 hours of such emergency application.

If for any reason such emergency hearings cannot be held by the Bankruptcy Court within 48 hours of such filing, it should be specified that the Debtor may immediately proceed in the United States District Court where the Chapter 11 proceeding is filed.

E. SECTION 331

Section 331 should be amended to provide that Debtor's counsel or other professional persons are to be paid interim compensation after 120 days, irrespective of whether a plan of reorganization has been filed or approved. Payments are not to be based on contribution to the estate except as such may be used to determine bonuses or other extra awards.

F. SECTION 330

Section 330 should be amended to provide that Debtor's counsel or other professional persons may be allowed the rates they are customarily paid in their home place of business and that the choice of whom to employ is solely that of the Debtor. Reasonable costs and expenses for travel shall be allowed as well as for the time spent preparing the case and mapping its strategy with other employed persons.

G. SECTION 349

Section 349 should be amended to provide that the Bankruptcy Court may enter orders that relate to the payment of administrative expenses prior to any dismissal of case.

H. SECTION 365

Section 365(d)(4) which requires the Debtor to affirm a lease on non-residential property within 60 days, should be amended to provide that this section shall not apply to a farmer.

I. SECTION 542

Section 542 should be amended so that emergency applications for turnover of property to Debtors must be heard and a final order entered within 48 hours of such application.

If for any reason such a hearing cannot be held by the Bankruptcy Court within 48 hours of the filing of an application for turnover of property, it should be provided that Debtor may immediately proceed in the United States District Court where the Chapter 11 proceeding is filed.

J. SECTION 506

Section 506(c) should be amended to make it very clear that American Mariner is repudiated and that no undersecured claim shall draw interest during a Chapter 11 proceeding.

K. SECTION 1102

Section 1102 should be amended to provide that no secured creditor or partially secured creditor shall be a member of any Unsecured Creditors' Committee, irrespective of whether such creditor is also the holder of an unsecured claim.

L. SECTION 1104

Section 1104 should be amended to prohibit the appointment of a trustee in a Chapter 11 proceeding for a farmer without his express written consent.

M. SECTION 1112

Section 1112(b) should be amended to provide that no Chapter 11 proceeding can be converted or dismissed sua sponte by the Bankruptcy Court or on the motion of the U.S. Trustee, and that the U.S. Trustee is strictly prohibited from taking an adversarial role of any kind in the Chapter 11 proceedings directly or indirectly.

Further, that no Chapter 11 may be dismissed where a plan and disclosure statement are on file, but that in such a case, the plan and disclosure statement must be first heard under Section 1129 of the Code.

N. SECTION 1121

Section 1121 should be amended to increase the exclusive period for farmers for filing of the plan of reorganization to 240 days and confirmation of the plan to 300 days.

This section should be further amended to prohibit liquidating plans from being filed by creditors in farming reorganization proceeding or any other devices or schemes which result in involuntarily liquidations of farmers.

O. SECTION 1125

Section 1125 should be amended so that the Court shall not unreasonably delay the approval of a Debtor's Chapter 11 disclosure statement, but promptly act thereupon.

Further, this section should be amended to provide that amendments to the disclosure statement may be allowed by the Court at any time including the hearing on the disclosure statement, so as to further expedite and shorten the confirmation process.

P. SECTION 1129

Section 1129 should be amended to make it very clear that the absolute priority rule of former Chapter X Bankruptcy proceedings does not apply to Chapter 11 proceedings under the Bankruptcy Code and is forever abolished.

This section should be further amended to provide for a separate hearing on cramdown to be held within 30 days of the confirmation hearing. Further, that the values to be used in the cramdown hearings are to be the value of the assets involved on the effective date of the plan.

CONCLUSION

Congress should not hesitate to intervene to assist farmers who, through no fault of their own, are about to lose their farms because of the unfulfilled expectations and grand promises made by this government and lenders.

The first step, reorganization of farmers, can best be accomplished by improving the legal mechanisms already in place. It is not too much to ask Bankruptcy judges to guard farmers as they guard other debtors. The first day's testimony before this Committee, however, has conclusively proved that bankruptcy judges need additional instruction and guidelines in order to do an effective job of guarding farmers.

We propose that all farmers have the opportunity to reduce their production gradually to proper levels. Farmers do not need to farm fence-to-fence to make a profit, but rather simply need to be freed of the unbearable debt loads they carry. As Americans, we should be willing to provide such relief, but in any event, providing such relief only serves our own best interests. We have no problem with shifting the farm debt burden from farmers to lenders and suppliers, for they are largely responsible for the crisis we face. But, in the end, their problems can be handled efficiently and expeditiously as their need arises and must be met.

We would be foolish to permit the loss of 700,000 farmers and would find the cost of that unendurable.

In closing, we are reminded of two men -- Sewell Avery of Montgomery Ward and General Robert Wood of Sears, Roebuck. At the end of World II, Mr. Avery predicted world-wide depression because that was always the result of self-cleansing by the free-market. General Wood wisely advised that the fate of the economy depended upon what the government did, for he had greater faith in the ability of men to solve their problems. Over the intervening years, the government in general has not acted unwisely, for we have enjoyed the longest, uninterrupted period of prosperity in the history of any nation.

The present farm crisis is unsolvable only to those who refuse to solve it.

Respectfully submitted,

William L. Needler
William L. Needler & Associates, Ltd.
Marquette Building - Suite 400
140 South Dearborn
Chicago, IL 60603

APPENDIX A

December 6, 1983

Honorable John B. Jones
U.S. District Judge
202 Federal Bldg. & U.S. Courthouse
400 S. Phillips Avenue
Sioux Falls, South Dakota 57102

RE: Pre-sentence statements on behalf of Bellman Farms Inc. and Charles J. Bellman, CR83-30016-01 and 02

Dear Judge Jones:

I am writing the following letter and statements in regard to the sale of grain for which Bellman Farms and Charles J. Bellman were indicted. These indictments are referred to as Count I, Count II and Count III.

I believe that I am not guilty of any of the three counts, that Counts II and III are one and the same, the jury did not take into consideration the timeliness of the transactions nor the disposition of the proceeds and that I acted in a manner previously established as suitable. Likewise, I feel the U.S. Attorney made two or three statements of error in his summary that had damaging, irreversible effects on the jury. There never was any attempt to conceal the sales in Counts I, II and III. The PCA is better off after the sales in question than before. And, I was never given the opportunity to appear before the Grand Jury to present my side of the case or evidence on my behalf.

COUNTS II AND III ARE THE SAME

The Exchange or Assembly Report, marked Exhibit A, shows that the millet in Counts II and III were co-mingled at the Wecota Elevator. The only reason the two checks were issued was because of contract prices. The Plaintiff's witness, Dave Griffith of the Wecota Elevator, testified as to this contract, the cash price and why the prices were different. One was for $4.50 (cash) and the other was for $5.00 (contract) per cwt. The checks were issued at the same time, on or about September 30, 1981, more than six weeks before PCA inspected Bellman Farms on November 18 and about two months before they placed my loan in default on December 1. I testified with a statement to the jury that I could not understand why there were two counts on the millet.

ACTED IN AN ESTABLISHED, APPROVED MANNER

Testimony and exhibits in the court revealed that Bellman Farms Inc. was allowed to sell and keep proceeds for various reasons. The history of the procedure dates back to 1978-79 when letters to PCA state that proceeds were being used for purposes other than debt reduction and that all expenses were not paid by PCA drafts or checks. This can be determined by reviewing Bellman Farms Inc. General Ledger sheets marked Exhibits B and C. In 1979, $90,693.99 was derived from the sale of grain. Of that amount, $61,329.46 went to Commodity Credit Corporation (CCC). This can be seen on Exhibit B. In 1980, gross sales for grain were $63,159.62 and $34,341.55 was paid directly to CCC (Exhibit C). This was a common practice and was the practice I attempted to show the jury that payments of $3,567.24 (Check No. 3825) and $19,432.81 (Check No. 3818) went to pay CCC loans and other expenses. The U.S. Attorney implied that this was not a normal operating procedure.

Even assuming that Bellman Farms Inc. could not act in the "normal" manner as illustrated in the previous paragraph, then Bellman Farms Inc. check register entered as an exhibit in court could show: Aug. 24, 1981 through Sept. 10, 1981 (Checks 3903 to 3959) went directly for operating expenses in the amount of $24,734.09. Thus, the money went directly into maintaining Bellman Farms Inc. property as has been done in previous years. (Exhibit D)

Continuing, to utilize the millet sales from checks No. 3976 through 3985, $9,890.80 went into feed purchases and land rental from which feed was derived, and Check No. 3979 went to vet expenses in the amount of $2,202.65 to take care of PCA mortgaged livestock. (Exhibit E) These are only examples, but more than adequately cover the proceeds from the grain.

Exhibit F, which is included in the court exhibits, shows Bellman Farms Inc. proceeds from grain turned in to PCA in 1980. Out of a total sales of $63,159.32, grain income turned in to PCA totaled $24,251.31 plus $5,439.76 in CCC payments for storage and other farm programs. This is a difference of $33,468.25 that went from the grain income into various farm expenses and capital purchases.

In the Deposition of Charles J. Bellman, Jan. 30, 1982, Joe L. Maynes, attorney for the creditor's committee, established the grain sales were the same and handled the same as in previous years. (Exhibit G)

Thus, when Bellman Farms Inc. used grain proceeds in Counts I, II and III, they were used exactly as in 1979 and 1980 when similar security documents existed.

STATEMENTS OF ERROR BY THE U.S. ATTORNEY

The U.S. Attorney in his final argument told the jury that Bellman Farms Inc. received $100,000 from the Small Business Administration (SBA) and had drawn $74,000 from PCA.

Exhibit H shows the SBA loan was for $98,700 of which half or $49,350 went directly to PCA for debt reduction. The Form 1050 referred to on the second page tells how the money was spent. The additional $49,350, by loan requirements, was used to pay existing bills and operating expenses. How this money was spent is on file in the SBA office in Sioux Falls. Exhibit H also shows on the third page that SBA wanted PCA to subordinate the mortgage they had. This was never done because of my efforts. Eventually, the payment of $49,350 went to PCA and SBA took a secondary position to PCA. This is further documented in Bellman Farms Inc. Chapter 11 Reorganization Plan on file in the Bankruptcy Court and in the report of Mike D. Eichelberg, U.S. Probation Officer.

The last PCA draft was written in late July or early August to Swanson Bros. for pasture rent in the amount of $19,200 and to Braun trucking for $1,740. All PCA drafts written by Bellman Farms Inc. were included in court exhibits.

From August 1, 1981 to December 1, 1981, Bellman Farms Inc. was not in default with PCA. On Dec. 1, 1981, Bellman Farms Inc. filed a Chapter 11 reorganization, at which time $75,138.10 were listed in outstanding and unsecured bills. (Exhibit I) This was later amended to $89,830.75 as listed on the second page of Exhibit I and included in the Third Amended Chapter 11 Plan of Reorganization.

The statements as to the money Bellman Farms Inc. had at its disposal during its final four months prior to the filing of a Chapter 11 are in error. Irreparable damage had been done that the attorney for Bellman Farms Inc. and Charles J. Bellman could not override in closing remarks.

NO ATTEMPT TO CONCEAL SALES

Bellman Farms Inc. and Charles J. Bellman made no effort to conceal the sales of grain in Counts I, II and III. All sales were delivered to the Wecota Elevator by a commercial harvester and Bellman Farms Inc. hired man, Don Flanigan. To conceal such a transaction would normally involve the shipment of grain under cover to a different buyer. However, in Counts I, II and III, business was carried on as usual and as it had been done since 1950 by Walter P. Bellman, father of Charles J., and as I have done since 1967.

The Plaintiff's witness Doug Paxton made no reference to any concealment of grain shipment or sales, nor did David Griffith, manager of the Wecota Elevator,

PCA BENEFITED FROM THE GRAIN SALES

Aberdeen PCA sued the Wecota Elevator for the grain purchased from Bellman Farms Inc. in which PCA claimed security interests. Joe Senger, PCA, testified that PCA won the suit.

Actually, the elevator lost. Any damages should be between the Wecota Elevator and Bellman Farms Inc. The reason the Wecota Elevator lost was brought out in cross examination of Dave Griffith by Mr. Gors. The counsel for Wecota Elevator, Thomas Kolker of Ipswich, S.D., failed to answer before or at the time of summary judgment. The Wecota Elevator lost the suit because they (Mr. Kolker) did not answer. Because there was no answer, the judge ruled in favor of PCA.

Griffith testified that PCA was paid in full by their insurance company, Farmers Union, and that the elevator was out the $1,000 deductible on the policy. PCA then applied the money to the Bellman Farms Inc. loan (as can be seen in the Cremer-Rohweder exhibit). That amount, about $35,000, could then be loaned out to other parties with interest.

The Farmers Union Insurance Company, if they can prove damages, are dealt with in Class 11 of the Bellman Farms Inc. Chapter 11 Plan. This provision, as shown in Exhibit J, was amended at the final hearing of Plan approval to allow up to $107,195.94 (page 3) in payments to those involved in contingent law suits.

PCA, rather than being damaged, collected twice . . . once when the grain money went into livestock feed and operating expenses, and secondly when they recovered full damages from the elevator through summary judgment default. Since PCA collected twice, as can be explained by the various exhibits at the trial, they have not suffered, but have gained from the sale of grain in Counts I, II and III.

PROCEEDS CO-MINGLED

The normal operation of Bellman Farms Inc. was to co-mingle funds and operate from three accounts: Bellman Farms Inc., Charles J. Bellman and Ace Cattle Company Inc. This was brought out in detail during the trial and represented in various exhibits. One of the Plaintiff's Exhibits, No. 74, illustrates this point. On this exhibit, more than $26,000 was on deposit. This was co-mingled money and could not be identified as other than "being on deposit." Co-mingled money was disbursed as (1) loans or transfers, (2) payments of operating expenses, (3) payments to PCA, (4) payments on term loans, (5) payments on contracts and (6) capital purchases. As testified in regard to the various counts, the proceeds for one commodity were used to purchase another commodity or to pay for operating expenses.

When money was disbursed from deposits, there was no way of knowing which dollars went for which payments. The only way this could have been done would be to write checks simultaneously with the deposit. This was never done or required to be done.

BELLMAN FARMS INC. AND CHARLES J. BELLMAN ON EQUAL TERMS WITH PCA

Since 1978 Bellman Farms Inc. has had a substantial loan with Aberdeen Production Credit. The loan grew so that it was the second largest, and at one time may have been the largest, that APCA had on its books. Any complaints that PCA has now voiced (after November 18, 1981) and after the filing of the Chapter 11 Reorganization schedules (December 1, 1981), could have been discovered at any time through their own diligence and prudence. Bellman Farms was never asked for its tax returns in full, general ledger or accompanying statement of receipts and disbursements as presented in its annual report by Cahill & Company, certified public accountants of Mobridge, S.D. Complaints made against Bellman Farms Inc., Charles J. Bellman and Ace Cattle Company Inc. have always been a matter of record and were clearly recorded in the companies' books.

Mr. Senger testified at the trial that Bellman Farms Inc. was to have its accountant send regular reports to them. Mr. Senger is confusing Bellman Farms Inc. with the account of Vogel and Sautner of Hoven, S.D. Bellman Farms Inc.was never instructed to send reports directly from the accountant. Prior to Dec. 1, 1981, PCA may have made one request from the accountant and it was answered. After Dec. 1, another request came from PCA President Delbert Lowe. The accountant refused because Bellman Farms was in a Chapter 11. Upon request by PCA, all of the Bellman Farms Inc. books were turned over to them for their examination.

On several occasions, PCA has attempted in Bankruptcy Court to (1) lift the automatic stay and (2) dismiss the reorganization. Their reason was loss of value, poor management. The bankruptcy court has always ruled in favor of Bellman Farms Inc.

TIMELINESS OF TRANSACTIONS

An important consideration of Counts I, II and III is when they happened in relationship to other circumstances. Chronologically, Bellman Farms Inc. continued to operate as it always did, at least until the middle of November 1981 when the trauma of possible foreclosure was real. The loan was due in full on December 1, 1981.

Although I was under duress because of drought, a serious lawsuit of about $500,000 in Nebraska over inadequate pasture for our cattle and the lack of operating funds, Bellman Farms Inc. continued to operate as normally as possible. At the same time, Bellman Farms Inc. was attempting to sell down and regroup at the home farm near Wecota, S.D. This involved the liquidation of large numbers of livestock. PCA, as evidenced by the various exhibits, and as detailed in the U.S. Attorney's final statements, received the major portion of the proceeds. Following are important dates, as evidenced by the U.S. Attorney's Exhibits:

March 25, 1981 -- PCA loaned Bellman Farms Inc. $1.083 million at 17%.
July 2, 1981 -- PCA placed the loan in collection (unknown to Bellman Farms Inc.)
July 25, 1981 -- PCA loaned $45,000 for pasture rent, operating and trucking.
Aug. 24, 1981 -- Bellman Farms Inc. sold durum wheat and rye (Count I). Proceeds were co-mingled and used as in 1978-79 and 80.
Sept. 30, 1981 -- Bellman Farms Inc. sold millet (Counts II and III). Proceeds were co-mingled and used as in 1978-79-80.
Nov. 18, 1981 -- Mr. Senger and Mr. Pond from PCA took inventory of Bellman Farms in the usual manner.
Dec. 1, 1981 -- Bellman Farms Inc. filed for Reorganization under chapter 11 of the Bankruptcy Code.
Dec. 15, 1981 -- PCA took an independent inventory without the debtor in possession of Bellman Farms Inc. present.

HOSTILITY OF PCA

Although the hostility of PCA has no bearing on the legal situation, it may have a great deal to do with the indictments and the manner in which the indictments were carried out.

In two instances, as recorded in the bankruptcy court, Judge Ecker recognized the "hatred" by PCA. The first instance was April 15, 1982. After a court inspection of the Bellman Farms Inc. estate, Judge Ecker commented on such an attitude toward the debtor. The second instance was during a hearing on the lifting of the automatic stay.

Neighbors and business associates have told me that PCA cannot let me win the reorganization. One PCA director said, if Bellman Farms wins, we will have more behind him.

The PCA attorney Carlisle Richards is a Federal Magistrate. Mr. Richards, of all people, must know that the Constitution guarantees a grand jury hearing. Yet, the first time I heard of the indictments was when two U.S. Marshalls, the county sheriff and deputy sheriff delivered the indictments to me while I was out in the field plowing for spring planting. The U.S. Marshall said to me something to this effect, "You probably know what this is all about?" I answered, "I'm usually the last to know." I had no idea what was going on. Then, the Marshall said, "You will probably want to go to Pierre and plead 'not guilty'." I said something like, "I guess that's right because I don't know what I am charged with."

ATTEMPTS TO RECONCILE WITH CREDITORS

Bellman Farms Inc. has made every attempt possible to pay creditors. Had we received the $500,000 damages from Swanson Bros., everyone would have nearly been paid in full. That did not happen. Swanson Bros. were also insolvent. But, when cash flow of Bellman Farms Inc. projected payments could be more than on the secured value of the estate, more than $85,000 was pledged in payments to unsecured creditors. This is explained in detail in the Plan.

PCA, under the proposed plan of reorganization, will receive $750,000 plus interest. They, also, forced Carmen Bellman into Bankruptcy and claim her interest in a $138,000 contract for deed. In the undersecured class, PCA will receive $66,327. The total amount, should they succeed in attaching the $138,000, is $954,327. They have also received a grain payment of $35,000 from the elevator, $24,000 in depreciation and some other smaller payments. The grand total they can recover, plus interest on that amount (the secured portion thereof) is $1.013 million, plus the accrued interest. Yet, they are not satisfied.

Bellman Farms Inc. and its debtor in possession Charles J. Bellman have made every effort to work out a Plan with PCA. This is illustrated in Exhibit K. The Debtor's attorney William Pfeiffer in the second paragraph (page 3) tells how PCA has refused to cooperate with Bellman Farms Inc. even though court orders were issued to do so. Although the Bellman Farms Inc. Plan can meet the "fair and equitable" test, PCA is interested only in punishment and liquidation.

CONFLICT OF FAMINE WITH PCA

The U.S. Attorney during the trial brought up an area of agitation of PCA toward me. We are helping farmers learn their legal rights. FAMINE, Farmers of America Merge In the Nineteen Eighties, is a source of information for farmers who are dealing with lenders, especially those who are hostile or in the process of foreclosing. We have published a book, (Exhibit L) "A Second Chance" and a monthly newsletter (Exhibit M) that deals with trauma of going broke and some of the legal alternatives. We have talked with many farmers who have contemplated suicide because they are about to lose their farms and homes that they have worked for all of their lives. We have had farmers tell us we have saved their lives and in several instances have saved their operations. We tell the farmers about the same rights they have that Itel Corporation, Continental Airlines, White Motor Company and other big companies are using to save their businesses.

We speak at meetings upon request. We have purposely stayed clear of speaking in South Dakota. We do not want to have what we are doing with FAMINE affect the rulings in our own bankruptcy case. We do not condone violence, only that farmers protect their property through the various legal tools that are available.

Because PCA is a national lending organization, they have not often welcomed the education we give their customers. We never present legal advice and always speak with an expert attorney on the same program.

STATEMENT OF ADMITTANCE AND RECORD

Bellman Farms Inc. and Charles J. Bellman admit to the sale of the property in question. The disposal of this property was in the same manner as has been done since 1950, 1967 and 1978. But, Bellman Farms Inc. and Charles J. Bellman are not guilty on counts I, II and III that there was intent to defraud, knowingly conceal, remove and dispose of and convert to our own use or that of another the grain in question.

Sincerely yours,

Charles J. Bellman

Charles J. Bellman, President
Bellman Farms Inc.
RR2 Box 46
Wecota, S.D. 57480

Senator **Grassley**. Chairman East.

Senator **East**. I have no questions, Mr. Chairman.

Senator **Grassley**. We would solicit responses from each of the witnesses to these questions.

As you know, the concept of adequate protection is derived from fifth amendment protections.

Can you discuss the constitutional implications of changes in this area; for example, would it be constitutional to amend this definition only for farmer-debtors?

Mr. **Kennedy**. Well, I think it certainly may be done for farm debtors. That is a reasonable classification, but all creditors of all debtors are entitled to constitutional protection of the fifth amendment. Some amendments might raise constitutional questions, but I think that an amendment of section 361 that deals only with farm-debtors would not be unconstitutional.

We had farm-debtor legislation enacted in 1935, the first farm bill that was upheld as constitutional, and it was not invalid for classification. I think the fifth amendment could be well satisfied, even though the legislation deals only with farm-debtors.

Mr. **Anderson**. I agree with Professor Kennedy on this issue, the constitutionality of the various statutes protecting the kinds of debtors. There is legislation in the 1930's and the original cases decided under that prohibited the moratorium of those statutes. However, in 1940, the Supreme Court decided two cases. In those cases, the Supreme Court permitted a 3-year moratorium on any sort of foreclosure proceedings, that sort of thing, so I think that it is perfectly constitutional to have a limitation on creditor action.

And as Professor Kennedy says, I do not see any reason why we should not create a special class. I would say in effect my suggestion would be, if I would make it, proposed in this regard, I think what we really need is a very short moratorium against requests for adequate protection, relief of stay, and so forth. Not 3 years, but 9 months to give debtors a chance to put together a reorganization plan. I see absolutely no constitutional limitations on that at least as an idea only because of the Supreme Court cases.

Senator **Grassley**. Let me assure you that it is not presumptuous on your part to make suggestions. Do not necessarily wait for an initiative from us, if you have got something to offer.

Mr. Needler.

Mr. **Needler**. Mr. Chairman, I think you can redefine the terms with regard to indubitable equipment, and it can apply to all debtors as well as farmers. And I think that should be done, because I disagree with the judge before you last week who said the debtor-farmer is different from the debtor-businessman. I think they are the same. They have the same problems and the standards of adequate protection. The problem is application. It is not being properly applied by some judges, and I think it can be done in a way that will assist farmers.

Senator **Grassley**. Mr. Needler, you state that loans on future crops should be deemed to be adequate protection. Is it not difficult for courts to predict with certainty what commodity prices are going to be in the months from the date that the plan is filed, and what problems do fluctuating commodity prices pose for plan confirmation in general?

Mr. **Needler**. My best answer, I think, Senator Grassley, my farm case, large farm case, was before Judge Nathans, and he said the same words in his testimony to you, and which he said to me, it is of record, he said to Judge Nathans, Your Honor, I was requesting use of collateral for the 1981 corn crop. We had a large farmer and 1,200,000—we had 500,000 bushels. I wanted to take that, sell it, and put it into escrow, and plant the 1982 crop. He denied it. We offered adequate protection on future lien on the crop. I said, Your Honor, if I was here asking you and I was representing a lumber yard in downtown Des Moines, and I asked you to sell the 2 by 4's in the bin, take the cash and reinvest it in 4 by 4's coming from the west coast, you would allow me to do that. His answer is yes, Mr. Needler, the code allows me to help the lumber yard. It does not allow me to help the farmer. He denied it. We appealed and it was upheld on appeal.

But is the future lien any different than the future lien on that 2 by 4's that can fluctuate, or is it any different from the car that we are going to buy from General Motors? I submit that was sufficient for the lender when he made the loan. He was in that speculative business. He was in that business. He undertook the risk when he got involved. He should undertake the risk now because it is no different, except it is court supervised.

Senator **Grassley**. Would you be in a position to suggest specific language to us consistent with what you just suggested?

Mr. **Needler**. Yes. On reflection, we could, Senator.

Senator **Grassley**. Now, to each of you on the panel, it is a fact that some farmers are just simply too far down the tube for a reorganization to work. It has been stated that the temporary breathing space afforded in chapter 11 is of no avail to many farmers, under today's farm circumstances.

In these cases, of what value is increasing the exclusive period for filing in chapter 11 plan to 240 days, some 8 months that seems to only allow collateral to deteriorate?

Mr. **Kennedy**. Well, I quite agree that giving more time will not save or help many farmers. I think we cannot possibly take care of all the farm debtors who are in dire straits, and the National Bankruptcy Conference agrees that there ought to be something like a $1 million indebtedness limit. Those that are excluded are not likely to be helped by giving them more time. I think we have to recognize that by bankruptcy legislation, we cannot help all of the farmers in dire straits.

Mr. **Anderson**. Senator, I am not so sure that we have any idea how many family farmers can make it under the bankruptcy laws, for the simple reason that I do not know many family farmers who have had a chance to reorganize. I sent my law clerk down to the bankruptcy court, and the statistics are not kept on a steady basis. First of all, in 1985, in our district, Nebraska, there were 174 chapter 11's filed—148 of them were farm bankruptcies. There were, in 1985 in Nebraska, according to my own unofficial research of the statistics, and I do not cite these as being guaranteed, about three or four plans confirmed, and they have been petitions filed in 1984. In 1985, in Nebraska, to date there have been 800 motions for relief, requests for relief by secured creditors, and I cannot break them down into farm bankruptcies or nonfarm bankruptcies, but they are 85 percent of the bankruptcies filed. Most of the time and energy spent, two lawyers, each of them spending 1 hour or so, and the judge is spending 1 hour or so on these motions, and there is no time for confirmations.

My view on the impact of an extended time, or liberalization of the bankruptcy laws and the effect on farmers who ought not to be there and cannot make it, my view on that is that we have not given anybody a chance yet, and what we really ought to do is give them a chance.

In most cases, in most States, and certainly this is true of Nebraska and Iowa, in most cases, if we did not have bankruptcy the lender or mortgagee would file a foreclosure action, which would take time, and bankruptcy stops that. But for bankruptcy it would be in most cases at least 1 year, and in many cases 1½ years, before the secured lender would get the collateral. At least for real estate.

What we are really saying is why do we not give an option to the farmer-debtor? Why do we not let him go in bankruptcy, give him a period of time free of all of these motions for relief, give him some time to look at these questions.

Now, if at the end of 8 or 9 months, when he has not been vexed with these motions for relief, then maybe we will have to do something about limiting the delays that are attendant upon the foreclosure action out of bankruptcy. It would be unfair to a creditor to have him sit for months in bankruptcy, and then have it dismissed, only to suffer the same delays all over again. It seems, whether we have foreclosures or give debtors a real chance in bankruptcy, the good ones who can make it, will, the bad ones will not. That is what is happening anyway. I do not think that we know what impact this will have. I do not think it will have a negative impact beyond what is happening anyway.

Mr. NEEDLER. Could I answer that? I may have a different view than some of the rest.

Increasing the time for a debtor's exclusive period to file a plan is going to make a tremendous impact, because creditors now will come to the table and start talking to debtors' counsel about workouts. Gentlemen, we have a terrible time with the obdurate creditor who says I do not want Jones to farm, I want him out of there. I want him out now, and I will not talk to you. And this goes on in farm cases in every State, and there is one in every case, and he is the guy who has got the farm, the equipment, and the second mortgage, if he has a time that he is going to have to spend, somehow that creditor is going to tell his lawyer, go over and see that debtor and let us start talking, and that will do it.

Senator GRASSLEY. I would like to refer a question to Professor Anderson.

This relates to your suggestion for freeing up cash collateral for operating purposes. You suggested that this be done without notice to the creditors, and I would like to ask about whether or not that is right, but also what would you think of a provision that would require a hearing in, say, requiring 48-hour notice that would give the farmer an opportunity to be heard?

Mr. ANDERSON. Well, addressing one question, I think any provision which speeds up the process for a hearing on spending the money, making it available, and getting new credit is a good one. So I would think that that would be very good, if we could make do by telephone conference and have a quick hearing on this question.

There is another part that my proposal relates to. I do not think under present law, section 552, it ought to be necessary for a hearing at all on the use of certain kinds of collateral, and I am talking specifically about milk from the dairy cow, and postpetition crops, and I believe section 552 can be interpreted as saying that collateral was not subject to a security interest. The only time you have to have a hearing on cash collateral is if somebody has an interest in it, and I think section 552 should be made clear that milk, postpetition crops, and postpetition cattle are not subject to the security interest. That does away with the need for any sort of hearing.

If that answers your question, Senator.

Senator GRASSLEY. Mr. Needler, I would like to ask a question based on some statements you made. Are you not working with the debtor and his creditors to work out repayment before you file for bankruptcy?

Mr. NEEDLER. In some cases—let us go back. I had discussed at some length here a question of bad faith. There is a question of whether someone files in bankruptcy should be charged with bad faith, and my contention is no. The farmer does not like to file chapter 11. He has too much pride.

So when the farmers reach this decision, and at varying points many times there is no time to consult with creditors, so one has to race to the courthouse for filing, but if there is time and there is an opportunity, our office makes every attempt to work with the debtor and his creditors to see if we can keep it out of court. And I think that most chapter 11 attorneys representing debtors do make that attempt.

Many times we are not allowed that privilege, however, because of time.

Senator GRASSLEY. I want to ask the entire panel a point that Mr. Needler just raised. Do any of you see a problem with last-minute, desperation, bankruptcy filings made just before foreclosure? Does this presume a bad faith filing on the part of the debtor?

Mr. KENNEDY. No. There certainly should not be a presumption of bad faith because of the last-minute filing. Most debtors do not go into bankruptcy unless that is the last resort.

Senator GRASSLEY. What legitimate purpose do these type of filings serve?

Mr. KENNEDY. It gives the debtor an opportunity to work out the resolution of his problems, a protection against the automatic stay.

Senator GRASSLEY. But is the debtor likely to get a plan confirmed after such a last-minute filing?

Mr. KENNEDY. I do not see why not, if he is given time to file a plan.

Mr. ANDERSON. I do not see this last-minute filing question has very much to do with whether or not a plan is likely to succeed.

Senator GRASSLEY. Well, let me raise a point. It could result in the interim deterioration of the loan collateral.

Mr. **Anderson**. My experience has been the way in which people deal with their lenders, if they are in default, and long term default, they will first try to work out some sort of voluntary plan.

What that usually means is some restructuring of the debt, although lenders tend to be very locked in to getting the full amount, and also giving these lenders additional collateral. Lenders want to have more collateral so the loan looks better on the books, and farmers, if they can do that, do. We see cases all the time where farmers are giving second mortgages, and so forth, but ultimately, if they cannot come up with some cash, that lender is going to start foreclosure proceedings. And it is at that point where the farmer has no choice. I do not know. It seems like at that point, if the farmer, if he wants to keep his property, has no choice but to go into bankruptcy, and that is why we have bankruptcies, so I do not think that this filing on the eve of foreclosure is something that implies anything like that. In fact, it strikes me as something that is very normal.

Senator **Grassley**. Well, I would thank you and suggest that we will continue talking with you about specific language.

Chairman East.

Senator **East**. Senator Grassley, I was curious about this matter. It seems to me that all three gentlemen are saying that late filing is not in and of itself presumptive evidence of bad faith. What things would you look for that would constitute bad faith, if timing is a factor of limited utility?

I would agree with Mr. Needler, that as a matter of pride and respect most people would want to avoid bankruptcy and certainly bankruptcy is not something anyone would want to have hanging over their heads. Most people want to do everything they can to avoid filing for bankruptcy but maybe at the last minute they do file it and do so with great reticence. It is a matter of human nature.

Farmers, like anyone, do not like to go into bankruptcy, but on this test of bad faith, what sort of things would we look for?

Mr. **Needler**. Well, let us say there was an article published in the Law Journal, and I think Professor Kennedy will recall. It is about 5 or 6 years old. It discusses this subject of bad faith. The one thing that hit me there, I believe, is bad faith, and this is my own opinion, and that is let us say we have a debtor here who has the Federal exemptions, $200 for each individual as an exemption, and he is an individual farmer and he has cash in the bank. And he goes out and he buys, let us say, $200 exemption, one, say, that one silver spoon is an exemption. He takes his liquid cash and he goes out and he buys exempt assets.

Now, that would seem to me that there is a farmer, if it was done by one, that that is bad faith. He is taking liquid assets out of the business, and, in effect, contrary to the intent of Congress, that, I think, is bad faith. But the farmer than runs in who has been told by the bank, let us say, we are working on your FmHA application, Mr. Jones, which is going to solve all your problems, and so Farmer Jones waits and waits and waits, and it is only at the last minute that his application is turned down, and he has read the article from the Des Moines paper that says chapter 11's will not work. And he has heard other people, the ministers say do not file bankruptcy, you would not do that kind of thing to us, and he files at the last minute to protect his assets, his farm, and the unsecured creditor, if you will, he is not guilty of bad faith, because he made a judgment upon somebody else.

Mr. **Anderson**. I think the Bankruptcy Code is adequately drafted to deal with the bad faith problems. The debtor who tries to convey away property to relatives under false sales, I do not mean to say it is done, but that can happen, but the Bankruptcy Code is written to permit the trustee, the secured creditors, to go after those things, and I do not think there is any particular need for legislation on bad faith questions.

You know, Mr. Needler was talking about the refinancing through the FmHA. We have had cases where banks have steered the farmer-debtor in that direction. It is very common for the banker to steer the farmer to FmHA for refinancing, and it is clear that that is where the bad loans get sent. Under these agreements, the banks have to agree to subordinate part of their positions to the FmHA, and we have seen cases where months have gone by where the banks steered the debtor that way, and then refused to subordinate. The farmer would then file bankruptcy. It looks like he is a real bad person, but if you look closer, he is doing it in an attempt to accommodate his bankers, and I would really urge that we not focus on those kinds of matters.

Senator **East**. So timing is an element.

Mr. **Anderson**. Yes.

Senator **East**. I had one other question with Mr. Needler's point about debtors having difficulty in getting attorneys of their choice.

Mr. **Needler**. Yes, sir.

Senator **East**. What do you think might be done to correct that? Is there anything that can be done to correct it?

Mr. **Needler**. I have set forth in my memorandum the type of a problem that exists for all of us; that is, that those people in those pilot districts, where there are pilot trustees, have appeared to spend most of their time, A, objecting to attorneys' fees, providing additional attorneys, if you will, for the creditors, paid by the U.S. Government who, in effect, work against the farmer, if you will, in reorganization. I find it hard to believe. We have had recent cases, and there is one that is pending today, I understand, got appointed even though we filed a motion for reconsideration, where debtors' counsel, and to me, it is a clear message, stay in Illinois, Mr. Needler. Do not come out here and work with farmers. Stay out of Minnesota. Stay out of Nebraska. That does not happen in other types of cases in my experience.

I was welcomed in Dallas. I was welcomed by Judge Gandy, by Judge Flowers. I was welcomed by the judge in South Carolina, but in some States there is a feeling that the counsel should be from just that State, although it is a Federal practice. We have had third-party retainers taken away recently in Minnesota in which no request for third-party retainer return was asked, where a debtor-farmer was not allowed a living expense. No money for food on the basis that there was no free property which could be sold. This farmer today is living on a grandmother's award. Our retainer has been turned back, and we are working for nothing. That has been affirmed on appeal.

Unfortunately, there are some gentlemen at the eighth circuit taking a look at that and seeing this irregularity as a lack of due process for the farmer. The farmer should be allowed the counsel of his choice, whether the farmer is from Iowa, would have Bill Needler come out, or somebody else, we should be treated, I think, in the same way. There are many reasons why farmers and other debtors choose counsel from outside of their State. And it is an increasing problem. And in the fee area, we are getting slaughtered. I have $1½ million in accounts receivable, and I am just a small man. I do not even know how we are here, but we are denied fees. We are put to standards which say we cannot pay you until the plan is confirmed. Creditors' counsels are paid every month on the dot, at much higher rates that we are. And we believe, we on behalf of the farmers who want to pay us should be allowed to make something. It is an unfair system that is being applied unfairly in some jurisdictions.

Senator EAST. Thank you.

Senator GRASSLEY. I have one last question that came to mind, and it relates to something I think Professor Anderson suggested.

What would you think about a moratorium on the relief of stay requests for 30 days? Eight or nine months, I think, was suggested, by Professor Anderson, and the reason I bring it up is that you had 18 suggested changes and you did not have that as one of them.

Mr. KENNEDY. We proposed to protect the debtor against the automatic termination of the stay. I would be troubled by prohibition on even seeking relief from the stay. I would have some question about the constitutionality of it, just prohibiting even seeking relief. There is not any constitutional difficulty in the grant of a stay for that period, but even to prohibit access to the court seeking relief seems to me to be a rather drastic remedy.

I think the National Bankruptcy Conference would stand by its recommendation that there would be discretion in the court to determine how long a period ought to go on before relief from the stay should be granted. I would have some trouble with a flow prohibition on access to the court seeking relief from the stay. Sometimes the stay ought to be relieved against.

Senator GRASSLEY. Do you have a closing statement?

Senator EAST. No; just thank the gentlemen for coming this morning.

United States Senate

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November 20, 1985

Prof~~f~~essor Frank Kennedy
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Ann Arbor, Michigan 48109

Dear Professor Kennedy:

Thank you for your valuable testimony before the Subcommittees on Administrative Practice and Procedure and Courts on November 12, 1985 concerning farm bankruptices.

Your response by December 9, 1985, to the following questions would be appreciated:

1. One of the National Bankruptcy Conference recommendations would make inapplicable the termination of the automatic stay after 30 days in a farm case. Please explain the need for this change. Should the Congress set a different time limit for the application of the stay? If so, what time would be fair to both farmers and their creditors?

2. One of the National Bankruptcy Conference recommendations would modify "adequate protection" by "taking into account the seasonal or cyclical nature of a farm debtor's business". Please elaborate on how this suggestion would operate in practical terms. What statutory language would be necessary to achieve this result?

Your cooperation in providing responses to these questions will greatly assist the Subcommittees.

Sincerely,

Chuck Grassley
CHARLES E. GRASSLEY
Chairman
Subcommittee on Adminstrative
Practice and Procedure

CEG;sgs

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FRANK R. KENNEDY
Thomas M. Cooley Professor of Law, Emeritus

December 6, 1985

Senator Charles E. Grassley
Chairman of the Subcommittee on Practice and Procedure
United State Senate Committee on the Judiciary
Washington, D.C. 20510

Dear Senator Grassley:

This letter responds to your request of November 20 for answers to the following two questions:

1. One of the National Bankruptcy Conference recommendations would make inapplicable the termination of the automatic stay after 30 days in a farm case. Please explain the need for this change. Should the Congress set a different time limit for the application of the stay? If so, what time limit would be fair to both farmers and their creditors?

2. One of the National Bankruptcy Conference recommendations would modify "adequate protection" by "taking into account the seasonal or cyclical nature of a farm debtor's business". Please elaborate on how this suggestion would operate in practical terms. What statutory language would be necessary to achieve this result?

1.

The need for the change respecting the 30-day termination of the automatic stay in a family farm debtor case is that it imposes too stringent a limitation of the time a family farm debtor needs for providing adequate protection of his secured creditors or for preparing and presenting a showing that he will be able to provide adequate protection during the pendency of the automatic stay.

The typical family farm debtor will not have an equity cushion, access to cash for making a lump sum or periodic payments within the immediate future, or for providing other forms of adequate protection recognized by 11 U.S.C. § 361 within the 30-day period. A family farm debtor seeking relief under the proposed Chapter is likely to be strapped by a lack of liquidity due to the fact that the debtor's land and farm equipment are so heavily encumbered he cannot borrow additional funds or provide additional collateral.

Section 362(e) presently authorizes the court, after notice and a hearing, to order the stay to be continued beyond the 30-day period pending the conclusion of, or as a result of, a final hearing. In order to continue the stay, however, the court must find that there is a reasonable likelihood that the debtor will prevail at the conclusion of the hearing, and the final hearing must be commenced within 30 days after the conclusion of the preliminary hearing. Bankruptcy Rule 4001(b) then terminates the stay 30 days after the final hearing is commenced unless the court denies the motion for relief within this 30-day period. In view of the difficulties confronting the typical family farm debtor, including one who may be able to propose a confirmable plan under the proposed legislation, the present law subjects the debtor and the court to distracting involvement in time-consuming, expensive procedures during a period when the debtor ought to be allowed to be developing a realistic proposal for providing adequate protection during the pendency of the stay and formulating a confirmable plan for submission to the court within the time to be fixed by the court.

The proposal of the National Bankruptcy Conference is that the 30-day time limit now prescribed by § 362(e) should not apply in a family farm debtor case under the proposed new chapter. An appropriate section of the new chapter might read as follows:

> SEC. ____. Automatic stay
>
> Section 362 of this title applies in a case under this chapter, except that the provision of section 362(e) terminating a stay of any act against property of the estate thirty days after a request under section 362 shall not apply in such a case.

The effect of this provision would be to leave the question of when the stay should be terminated to the discretion of the court, except as it would be automatically terminated under § 362(c). The result would be consistent with the practice that prevailed generally under the Bankruptcy Act after the promulgation of the automatic stay rules in 1973. The proposed section would also be consistent with the proposal of the National Bankruptcy Conference that the time allowable to a family farm debtor for proposing a plan should be left to the discretion of the court. Creditors would have access to the court, as they now have, to seek a termination or modification of the stay at such time as would prevent unnecessary delay or abuse of the opportunity afforded the debtor to provide for adequate protection and to formulate a plan. The court would retain authority on proper request of a party in interest to order payments or provision of other forms of adequate protection to a creditor whose collateral is being depleted or is deteriorating during the stay.

The recommendation of the National Bankruptcy Conference that the grant of adequate protection in a family farm debtor case take into account the seasonal or cyclical nature of a farm debtor's business recognizes that it will often be impracticable for a family farm debtor to provide lump sum or monthly payments by way of adequate protection immediately or even promptly after the filing of the petition by the debtor. The recommendation contemplates that the court could approve an order that allows the debtor to remain in possession of encumbered real property, equipment, and other collateral and to use the property without being required to make payments or to provide new collateral during the growing season and before the farm debtor has harvested the products of the season. The recommendation of the National Bankruptcy Conference could be implemented by a section of the proposed chapter on family farm debtor relief that includes the following language:

> SEC. ____. Adequate Protection
>
> (a) Except as provided in this section, section 361 of this title applies in case under this chapter.

> (b) In acting on a request for adequate protection the court shall take into account the seasonal or cyclical nature of a family farm debtor's operations.

A section-by-section analysis could include illustrations of appropriate orders.

This response has been limited to an elaboration of the views of the Conference as they were expressed at its Annual Meeting on October 25 and 26, 1985, and as understood by member of the Conference's Committee on Farmer Insolvency. Names and addresses of the members of this committee are appended at the end of this communication. If additional elaboration of the above answers is desired, I shall undertake to provide it on request.

Sincerely,

Frank R. Kennedy

FRK/dw
Enclosure

Senator GRASSLEY. I would like to again thank all of the witnesses for their thoughtful presentations today. After these 2 days and 17 witnesses, it is apparent that the committee faces a difficult assignment in amending the Bankruptcy Code for family farmers

First, we must realize that amendments to the Bankruptcy Code are not the answer to the farm crisis—no matter how well intended; the answers to the farm crisis lie well outside this committee's jurisdiction. I urge my colleagues to go on about this task as we have never done before.

We must further recognize that any Bankruptcy Code changes we make may have unintended side effects on other components of the rural economy. The unfortunate fact of the matter is that trade creditors and other rural main street businesses are not in the best of health either.

We must preserve the delicate balance that exists between the farmers legitimately trying to reorganize and the rights of creditors.

These 2 days of witnesses have given us ample support for fine tuning existing law to help farmers. There is also precedent for making these amendments solely for the farmer's benefit, perhaps in a separate chapter or subchapter of the code. At a minimum, I envision changes to those terms in the code such as "adequate protection" that have been applied in a restrictive manner, making farmer reorganizations unreasonably difficult.

I believe we need to correct restrictive court interpretations in a way that frees up the use of cash collateral and helps to stave off attempts to lift the automatic stay.

I hope we can make these amendments to the Bankruptcy Code with precision; that we use a surgeon's touch—so that the changes will not unduly damage the system of farm credit.

With those statements, I will dismiss the witnesses and declare the hearing closed.

Thank you all very much.

[Whereupon, at 12:40 p.m., the subcommittees adjourned, subject to the call of the Chair.]

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